POLLUTION CONTROL FINANCING FOR SMALL BUSINESSES

HEARING

BEFORE THE

SUBCOMMITTEE ON ENERGY, ENVIRONMENT, AND SAFETY ISSUES AFFECTING SMALL BUSINESS

OF THE

COMMITTEE ON SMALL BUSINESS HOUSE OF REPRESENTATIVES

NINETY-SEVENTH CONGRESS

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POLLUTION CONTROL FINANCING FOR SMALL BUSINESSES

WEDNESDAY, NOVEMBER 4, 1981

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON ENERGY, ENVIRONMENT, AND
SAFETY ISSUES AFFECTING SMALL BUSINESS,
COMMITTEE ON SMALL BUSINESS,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:30 a.m., in room 2359-B, Rayburn House Office Building, Hon. Berkley Bedell (chairman of the subcommittee) presiding.

OPENING STATEMENT OF CHAIRMAN BEDELL

Mr. BEDELL. The Subcommittee on Energy, Environment, and Safety Issues Affecting Small Business of the House Small Business Committee will come to order.

This morning, our subcommittee is meeting to consider the issue of pollution control financing for small businesses. This is a timely and important subject.

A decade ago, our society came to a realization that we were endangering ourselves and our environment by our continued pollution of the air and water. A series of environmental protection laws was enacted, and recent public opinion polls show that the laws designed to assure clean air and clean water for the American people continue to enjoy overwhelming popular support.

When the pollution control laws were enacted, it was recognized that achievement of their goals would entail some substantial expenditures. Specifically, it was understood and agreed that some small businesses would need assistance in financing the cost of the equipment they would need in order to comply with the new laws.

Congress has established several programs to help firms with pollution control financing. Some of the laws, such as special tax treatments and pollution control bonds, theoretically are available to all businesses. Others, particularly the SBA's pollution control loan guarantee program, were designed specifically for small businesses. The Library of Congress, at the subcommittee's request, has prepared two papers outlining the various relevant programs and these reports shall be made a part of the hearing record.

[See Appendix A, p. 71.]

Mr. BEDELL. The purpose of today's hearing is to provide an overview of whether and how these programs are working. In particular, we want to know which programs are of greatest value to the small firm that needs help with pollution control financing.

We want to know which programs the small businessman uses, and how he uses them.

Of great concern to the subcommittee is the current status of some of the programs that have been established to help businesses meet their pollution control financing needs. There have been no significant changes in any of the major pollution control laws and the costs of complying with them have not diminished. In fact, inflation and high interest rates have driven those costs up in the recent years.

Yet, we see the Treasury Department taking steps to eliminate small-issue, tax-exempt industrial revenue bonds. Increasingly, these have been viewed as a major source of funds for pollution control financing associated with new industrial developments involving small businesses.

We also hear rumors that the administration will recommend the elimination of pollution control bonds when it submits its proposals for reductions in tax expenditures. That message is now several weeks overdue, and we await it with keen interest.

Finally, we note that the Office of Management and Budget has directed the Small Business Administration to operate the pollution control loan guarantee program at an activity level substantially below that which has been approved by both houses of this Congress. The new program level, in fact, appears to barely cover the commitments that were outstanding at the start of this fiscal year. In essence, this would mean no new loan guarantees could be issued under this program this year.

The subcommittee is anxious to learn about what impacts these policy changes are likely to have on the small business community. And, of course, we will be exploring other issues as well.

Today's witness list includes pollution control officials from several States who will tell us about the financing situation from the perspective of the enforcement agencies. Then, we will hear from representatives of the Small Business Administration, who will discuss that agency's pollution control loan guarantee program. And, last but certainly not least, we have several witnesses from the private sector who will tell us about their experiences in solving pollution control financing problems.

We will proceed with the hearings.

Our first witnesses are Robert E. Patterson, executive director of the Massachusetts Industrial Finance Authority; Terrence Curran, executive director, New York State Environmental Facilities Corp.; and William C. Elliott, executive director of Ohio Air Quality Development Authority.

We ask you to identify yourselves as you start. We will hear first from Mr. Patterson, unless there is objection among you.

Whether you read your testimony or summarize it, your entire testimony will be made a part of the record.

PANEL CONSISTING OF ROBERT E. PATTERSON; TERRENCE CURRAN; WILLIAM C. ELLIOTT, ACCOMPANIED BY JAMES YOUNG

TESTIMONY OF ROBERT E. PATTERSON, EXECUTIVE DIRECTOR, MASSACHUSETTS INDUSTRIAL FINANCE AGENCY

Mr. PATTERSON. Yes, thank you, Mr. Chairman. It is my pleasure to be here. I am executive director of the Massachusetts Industrial Finance Agency.

I will submit my full testimony, but I would like to summarize a few of the high points of what I think is particularly important today, particularly given today's market conditions and the programs that you spoke so clearly about.

In Massachusetts, industrial revenue bonds have been very important in a State which in 1975 had an unemployment rate of almost 12 percent, practically 50 percent higher than the national unemployment average.

Today we are enjoying an unemployment rate that is significantly below the national average and ranks very well amongst the industrialized States.

In Massachusetts, in 1975, we had a very small, almost nonexistent, revenue bond program, and last year, in 1980, industrial revenue bonds financed approximately half of all the new industrial space added in the State.

Now, pollution control has been especially important in that program. As we all know, pollution control expenditures by small companies are basically nonproductive expenses to the company. They are for a social goal, but to the company they do not add to profitability, and, in fact, they add to the expense. High interest rates do nothing more than increase that burden.

In Massachusetts we have used the SBA program. It enables small companies to get into the national credit markets, and it has been a very good program for us.

The Springfield Foundry out in Springfield, a major employer, Seaman Paper Co. in Otter River, and there are others that we are working on right now.

The tax exemption is under attack once again by the Treasury which, as far as I can see, has never liked tax-exempt financing, especially now that high conventional interest rates and the graduated income tax have made it important.

Last year they got mortgage revenue bonds; this year they are after industrial revenue bonds.

I would say revenue ruling 81-216, which I am sure you are going to hear more about in the hearing today, is just the first step in this year's attempt to cut back on tax-exempt financing for private employers.

That ruling has absolutely wreaked havoc with the SBA guarantee program, turned it on its head, increased transaction costs, and pretty well prevented us from doing the pooling which was the whole idea of Congress when it passed the program to begin with.

Most importantly, that ruling is unbelievably unfair to small business which is the reason for passing the SBA guarantee program in the first place.

I will return to revenue ruling 81-216 in a few moments, but first some general thoughts on where I see tax-exempt financing for private industry, otherwise known as industry revenue bonds, going in general.

There is no question that IRB's are the subject of lots of criticism. Everyone has heard about it, even if they have not seen 60 Minutes, and the aura of abuse and tax avoidance is floating around in a highly charged atmosphere.

The rhetoric is obscuring some facts, and I would like to turn to some of those facts as we see them. The industrial revenue bond program should be targeted, and I have written an article which Congressman Moakley inserted in the Congressional Record which argued that changes should be made in the industrial development bonds, or the baby will get thrown out with the bath water.

Before that happens, I would like to focus on some of the positive facts about industrial revenue bonds.

The abuses have been in the area of commercial real estate, which is very controversial between States. In Massachusetts we allow that only if it is in a downtown area. In Massachusetts we have 39 older cities, lots of old buildings, and I can't tell you how many good things that program has done in 2.5 years in terms of revitalizing our older industrial areas and stimulating almost $150 million of new investments in these areas, areas that 5 years ago everyone told us were dead forever.

I would also like to point out some national facts from the CBO Report which came out in April of 1981. First of all, that report found that this is overwhelmingly a small business program. The $10 million capitalized expenditure limit, though much criticized, really has succeeded in channeling this, by and large, to smaller companies. Only 7 percent were Fortune 1,000 companies—$10 million today in fact is worth less than the $5 million in terms of plant and equipment that it can buy, that Congress adopted as the limit originally in 1969, so it is not fair to say that the window of eligibility is widened.

In fact, it is smaller today than it was when Congress acted to restrict the bonds in 1969.

Nationally, the Congressional Budget Office report also found that over 90 percent of the users in the last 2 years were not listed companies on any national or regional stock exchange.

You can measure small business in lots of different ways, but to me that is a very sensible way when talking about a financing program, because what we have found is that the important thing is the sources of financing available to these companies, and if they are not listed, they are dependent on their local banking system for capital.

In Massachusetts, IRB's also have been a small business program. Half the companies had sales under $5 million, and three-quarters have had sales under $20 million.

To give you a better picture of what the company that uses IRB's is like, we ran some numbers on 1980 companies that used the program. Half of the companies in the entire sample had sales under $5 million, and we found that these companies on average were borrowing $655,000 for new plant and equipment.

Everything must be compared to something else, and what does this $655,000 compare to? That is compared to a net worth of $500,000, sales of $2 million, and net income of $120,000.

In other words, these companies on average were borrowing 5.5 times their net income, and 1.33 times their net worth. And you have to keep in mind that these highly leveraged companies—and smaller ones are more leveraged than larger ones in general—have a lot of working capital debt, and most of that is floating at the prime rate plus.

These are companies with courage, investing large amounts of money at a time of rising interest rates and economic uncertainty.

I think prolonged periods of high interest rates will kill a lot of companies, but what would happen in Massachusetts if IRB's were stopped? No one can tell for sure because no one knows how many of the projects would have gone ahead, and what the effect of these interest rates would be on the capitalization of small companies.

At the national level, the Congressional Budget Office projected, if the program was allowed to continue, IRB's by 1986 would add over $4 billion to the gross national product, including over $2.2 billion in private salaries and wages, which after all pay for government at all levels.

That is enough to employ 150,000 people at a $15,000 a year wage.

That puts it in context as to the benefits of the program, and at a cost the CBO report felt would be $700 million in 1986.

Other figures on estimates on cost are available from a study done at the University of Chicago Business School and available from the Small Business Foundation of America which projects substantially smaller costs—$700 million is not going to balance the budget in 1986, or any other year; but dropping IRB's could have a dramatic effect on small companies, especially at a time of high interest rates.

We did a survey of the users of the program in Massachusetts. We mailed it to all of them that had received our financing.

I am surprised to report that a third of them responded, and you have to put yourself in the position of a small businessman with yet another piece of paper coming across his desk from Government. Most of them I thought would end in the scrap basket, but a third responded and of those, 93 percent said over the last 2.5 years without an industrial revenue bond, they would have had to alter their investment plans. A third would not have gone forward, a third would have delayed, so two-thirds would not have done their project, and another fifth would have expanded but expanded less by an average of 36 percent.

I have to point out, interest rates were rising over that period of time. If you went out and took that survey on a sample in time of right now, you would find that the effect of the interest rate subsidies through industrial revenue bonds is even more dramatic than that survey has shown.

I think it is very important that everyone understands what the true effect of revenue ruling 81-216 is likely to be.

I would like to quote from a letter that the Governor of Massachusetts recently wrote to the President.

This ruling effectively closes off reasonably priced credit for small businesses while leaving the tax-exempt market available for their larger competitors. These unfair competitive effects are indefensible * * *. It is a fact that smaller, unrated companies cannot sell bonds in the public markets unless they purchase additional collateral [insurance, bank letter of credit, or SBA guaranty]. It is bad enough that these companies must pay higher rates to purchase the collateral they need to buy access to the national debt markets. It is unacceptable, however, that the IRS with revenue ruling 81-216 should bar them from these markets on the sole technicality that the additional collateral has been purchased.

Under the guise of Tax Code technicalities, the Treasury is forcing small businesses out of IRB's. The reality of this ruling will be to tell smaller companies that they cannot get financing from the national credit markets. Given today's commercial banks' prime rate and the condition of the thrift industry, plus the fact that approximately one-half of the banking assets in Massachusetts are held by thrift institutions, this is tantamount to telling these companies that they can finance their real estate expansions only as tenants of big developers. Being a tenant in a big industrial park is not what most of the small businessmen I have worked with want as part of their business plan for growing, adding jobs, and investing in the future.

Finally, I will close with a quote from the CBO:

If the Congress eliminated tax exemption on small issue IRB's some investments might not move forward. Others might move ahead, but changes in the amount and timing of the investment would result. Smaller firms would be the most affected. Moreover, investment in distressed urban areas might decline because of the large number of UDAG projects that also receive IRB financing.

Based on my experience in Massachusetts, I could not agree more with this prognosis from the Congressional Budget Office report, and I urge you that this is no time to be ending a program that has proven its usefulness. Restrict it perhaps, improve it for sure, but let's not end it.

[Mr. Patterson's prepared statement follows:]

PREPARED STATEMENT OF ROBERT E. PATTERSON, EXECUTIVE DIRECTOR, MASSACHUSETTS INDUSTRIAL FINANCE AGENCY

November 4, 1981 - Mr. Chairman and honorable members of the subcommittee: Everyone seems to agree that the United States should direct its economic resources toward the goals of higher productivity and more jobs. An essential part of this effort has to be aid to smaller innovative companies and distressed areas.

I can speak from the perspective of five years in state government devoted to restoring the economic vitality of an old Northeastern state where the country's industrial revolution began and which today comprises about half the New England economy. Though we have a long way to go to restore our region to prosperity, Massachusetts' recovery from a 12% unemployment rate and countless vacant mill buildings in our historic cities has dramatically exceeded everyone's expectations back in 1975. Government incentives to induce productive private investment have played an extremely important role in this recovery despite the highest interest rates in our history.

Critical federal programs have included the Urban Development Action Grant and Community Development Block Grants administered by HUD, and incentives provided through the Small Business Administration and the Economic Development Administration. All these programs and agencies have experienced major funding reductions in the 1982 budget. As you well know, we may face even more budget cuts in the future.

With interest rates still hovering at 20 percent and federal assistance to small business and urban development declining, there remains one important incentive available to state and local governments to assist growing smaller companies and distressed areas. Industrial development bonds still offer smaller companies their only real opportunity to borrow at affordable interest rates for productive investment in plant and equipment. And if responsibly targeted these bonds can provide distressed areas the most powerful development incentive likely to be around for the foreseeable future.

Moreover, industrial revenue bonds have been crucial to small companies adding pollution control equipment to protect our environment. Pollution control equipment is required by standards put forth by federal and state governments to achieve an important social objective, but these mandated expenditures add to company's cost without any return in most cases. I feel very strongly that if we are going to make small business invest in non-productive assets for a social goal, then at the same time we must be willing to leave resources such as IRBs available to them so that they can afford the pollution control expense.

A good case in point is the Springfield Foundry Company in Springfeld, Massachusetts. Formed in 1854, the company does special iron casting work. The Environmental Protection Agency and the Occupational Safety and Hazard Administration required the firm to install an emission control and air filtration system to protect the company's workers and the environment. The company has only 115 employees and less than $5 million in sales, but is an important supplier and employer in Western Massachusetts. Without an $875,000 IRB and an SBA guarantee this new equipment would have been a severe burden to this company after almost 130 years of operation.

Now industrial revenue bonds are under major attack. The Treasury, which to my knowledge has been opposed to all tax-exempt financing with varying intensity since the introduction of the graduated income tax made that exemption valuable to state and local governments, has fired the first salvo in this year's attack by springing Revenue Ruling 81-216. This arbitrary ruling was issued without any notice or opportunity for public comment. It represents a dramatic reversal of prior IRS policy. In fact, it expressly revokes three prior rulings which have been relied on by many states in their programs to assist farmers and small business.

Underneath the technicalities of Rev. Ruling 81-216 lies a very simple practical fact. This ruling will effectively close off reasonably priced credit for growing small businessmen and farmers. It will wreak havoc with the Small Business Administration's guaranteed bond program for pollution control financing, which was just expressly increased by Congress. And most importantly of all, it will have unbelievably unfair competitive consequences for smaller business vis-a-vis their larger competitors--an unfairness which was the reason why the SBA pollution control guaranty program was started in the first place.

I will come back to Rev. Ruling 81-216 in a moment, but first I would like to offer a few observations on industrial development bonds in general which may be timely as the Treasury has said it wants to eliminate or severely restrict in the very near future.

IRBs have come in for some very bad publicity recently, starting with the media reports of the Congressional Budget Office's findings and a relatively few sensational abuses. I cannot defend the way all industrial revenue bond programs have been operated throughout the country. My recent article in Commentary magazine, which was inserted in the Congressional Record by Congressman Moakley, argued that changes should be made in industrial development bonds. In my opinion the program must be more effectively targetted or this powerful incentive will not survive.

It is critical, however, that Congress not throw out the baby with the bath water and that some reasonable discussion take place to preserve what is worthwhile and perhaps essential in the current environment of high interest rates. I would like today to point out how we have used IRBs in Massachusetts, and how important they have been to our smaller companies and distressed areas. In passing, I would also like to point out some facts contained in the CBO's report, facts which have been widely overlooked.

First, CBO found that IRBs, thanks to the $10 million capital expenditure limitation, have been used primarily to finance the growth of smaller companies. CBO found that over 90% of IRB recipients in 1978 and 79 were not listed on any national or regional stock exchange. Furthermore, of some 8,000 small issues in those two years, only 7% went to the top "Fortune 50" non-industrial or the "Fortune 1,000" industrial firms.

In Massachusetts one-half of the industrial companies we have assisted have sales of less than $5 million, and some three-quarters have sales of less than $20 million.

Let me try to give you a better picture of what IRBs have meant to the growth of these companies. The average company with sales under $5 million borrowed $655,000 for productive assets. Since almost everything is a question of "compared to what", this new debt has to be compared with a net worth of $500,000, sales of $2 million and net income of $120,000. Considering that these companies also have other major debt, much of it at interest rates floating above the prime rate, these companies were undertaking very major expansions, borrowing over 5 1/2 times their net income and 1 1/3 times their net worth at a time of rising interest rates and widespread economic uncertainty.

There is, of course, continuing debate as to how many companies would have expanded without IRBs. Intuitively you just have to consider the figures I just recited to know that the lower IRB interest rate was important in the decision to invest in long-term productive assets. It is probably impossible, however, to know with certainty precisely what the stimulative effects of IRBs have been.

At the national level, CBO estimated in its report that IRBs will generate over $4 billion in additional gross national product in 1986. CBO's projections show that IRBs in that year will be responsible for additional private wages and salaries totalling $2.25 billion, enough to employ 150,000 people at $15,000 a year! And this stimulative effect, again by CBO's estimates, would cost the federal Treasury (i.e. revenues which the Treasury would have to spend were IRBs to be eliminated) of only $700 million or less than $5,000 per job.

Even these cost figures estimated by CBO may be too high. Further work on this question showing substantially smaller costs to the federal Treasury has been done by Professor Kormendi at the University of Chicago Business School on a project for the Small Business Foundation of America and my agency.

I suggest that $700 million will not prove significant in 1986 in balancing the budget or bringing down interest rates. The elimination of IRBs, however, would have a devastating effect on the expansion of smaller companies until interest rates decline.

At the state level, in Massachusetts we are just completing a survey of those companies which my agency has assisted with tax-exempt financing. Surprisingly, approximately 1/3 of the companies answered even though we made it clear that the survey was completely voluntary. Of those responding fully 93.1% indicated that they would have been forced to alter their investments if IRBs had not been available. One-third of the companies stated that they would not have been able to expand at all without an IRB. Another third said they would have delayed their expansion without IRBs. And one-fifth said that they would have expanded less due to higher interest costs in the absence of IRBs.

Incidentally, these companies responding reported having already added 80% of the new jobs they projected at the time of starting their IRB-assisted project. In total, these projects in Massachusetts will create more than 40,000 additional jobs when completed and in full operation.

Financing of commercial enterprises with tax-exempt bonds nationally has caused, in my opinion, much of the uproar and publicity about "abuses". But we should not lose sight of the fact that, particularly at today's interest rates, the IRB incentive if restricted to distressed areas can be a powerful development tool.

In Massachusetts over the last 2 1/2 years we have assisted 72 commercial urban revitalization developments. Though only 9% of our bonds, these projects represent $150 million of new investment in our older distressed downtowns. Five years ago nearly everyone told me there downtowns would never be revived in a depressed state like Massachusetts. But rather than throw away our heritage, we carved out an excellent incentive program with IRBs for these downtowns which are so important to our past and our future. We added additional state incentives and public investments, and the results have surprised even the most optimistic of us working for city revitalization.

In closing, I think it is important that everyone understand what the true effect of Rev. Ruling 81-216 will be. As Governor King of Massachusetts recently wrote to the President, "This ruling effectively closes off reasonably priced credit for small businesses while leaving the tax-exempt market available for their larger competitors. These unfair competitive effects are indefensible....It is a fact that smaller, unrated companies cannot sell bonds in the public markets unless they purchase additional collateral (insurance, bank letter of credit, or SBA guaranty). It is bad enough that these companies must pay higher rates to purchase the collateral they need to buy access to the national debt markets. It is unacceptable, however, that the IRS with Rev. Ruling 81-216 should bar them from these markets on the sole technicality that the additional collateral has been purchased. "

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Under the guise of tax code technicalities, the Treasury is forcing small businesses out of IRBs. The reality of this ruling will be to tell smaller companies that they cannot get financing from the national credit markets. Given today's commercial banks' prime rate and the condition of the thrift industry, plus the fact that approximately 1/2 of the banking assets in Massachusetts are held by thrift institutions, this is tantamount to telling these companies that they can finance their real estate expansions only as tenants of big developers. Being a tenant in a big industrial park is not what most of the small businessmen I have worked with want as part of their business plan for growing, adding jobs, and investing in the future.

Finally, the CBO stated at the end of its summary on IRBs:

> "If the Congress eliminated tax-exemption on small issue IRBs some investments might not move forward. Others might move ahead, but changes in the amount and timing of the investment would result. Smaller firms would be the most affected. Moreover, investment in distressed urban areas might decline because of the large number of UDAG projects that also receive IRB financing."

I could not agree more with this prognosis based on my experience over the past few years in Massachusetts. Abolishing IRBs will save little or no tax revenue, and I urge you to restrict the program responsibly and in the process legislatively repeal Rev. Ruling 81-216.

Mr. BEDELL. We would ask you to submit for the record the letters and articles that you have mentioned.

You don't need to put in the whole CBO report.

Mr. PATTERSON. I know you have that.

Mr. BEDELL. We appreciate your testimony.

We will hear from all three of you at one time, and then ask questions.

Mr. Terence Curran, executive director of the New York State Environmental Facilities Corp.

TESTIMONY OF TERENCE CURRAN, EXECUTIVE DIRECTOR, NEW YORK STATE ENVIRONMENTAL FACILITIES CORP.

Mr. CURRAN. I am appearing on behalf of Robert F. Flacke who is the State commissioner of environmental conservation, and I have a rather short written statement I would like to read.

I might mention first of all, I am a professional manager, and a professional engineer.

My primary concern is the use of industrial financing in carrying out pollution control programs and more particularly as an incentive to get industry to be responsive to the Federal and the State mandates in environmental pollution control.

I am here today to support the efforts Congress is making to withdraw Treasury ruling 81-216 concerning small issue industrial revenue bonds and to oppose legislation which would eliminate tax-exempt financing for pollution control facilities.

The industrial development bond—IDB—and related pollution control financing programs have been of great importance to New York State for both economic development and the construction of pollution control projects. Without this financing vehicle, many small businesses would not have been able to secure needed capital for both business and pollution control needs. Conforming to environmental protection laws is a costly proposition for any company, especially small businesses. In recent years, industry and small business in New York State have been able to meet their environmental responsibilities without incurring high financing costs through the use of IDB's.

The IDB program has also been an important factor for the economic revitalization of New York State and has enabled small business throughout the Nation to remain competitive with other world companies. Manufacturers in our country are facing enormous competition from foreign companies who are heavily subsidized by their own governments. American industry would be at an even greater disadvantage if the Federal Government withdrew its support or made the IDB program impossible to function.

These small- and medium-size businesses who have used the small issue exemption to gain access to tax-exempt financing in the past will now be at a distinct disadvantage to their larger competitors. This is a burden that small business cannot afford to carry. Small business has to continue to have equal access to tax-exempt capital in order to effectively compete with both domestic and foreign companies.

New York State appreciates the concern in Congress over the abuses of IDB's to finance fast-food restaurants and discount stores, however, we believe that Treasury ruling 81-216 will undercut the

underlying purpose of the IDB program. As you know, the recent Treasury ruling will eliminate the ability of States to package a series of small business loans into a single tax-exempt "umbrella" or pooled bond issue. New York State has a number of public benefit corporations which have utilized pooled bond issues for both economic development and pollution control projects.

In the past, small businesses were forced to finance necessary pollution control project costs out of cash flow or with short-term bank loans. As you know, the Small Business Administration has given small- to medium-size companies access to the tax-exempt revenue bond market through the SBA loan guarantee program. This program enables small business to secure financing at the best possible interest rates.

In an effort to keep costs as low as possible under the SBA program, the pollution control financing requirements of several companies can be combined to create a single bond issue. In many cases the small issue exemption is used for this type of financing arrangement. For many companies the small issue exemption is also much easier to qualify under than other exemption provisions and will result in a more cost-effective financing. If the current Treasury ruling is not withdrawn the availability of pooling a number of companies together under the small issue exemption will be lost.

I understand that the Treasury is currently considering additional legislative recommendations on industrial development bond financing, including financings for pollution control facilities. While the legislation itself is still under development and it is not clear at this time what policy will emerge, it is my understanding that serious consideration is being given to eliminate tax-exempt financing for pollution control projects.

Implementation of this legislation would have a severe impact on the ability of all industry to meet the burden of financing mandated pollution control projects. I ask that Members of Congress strongly object to any legislation which would eliminate tax-exempt financing for pollution control projects. The benefits which have been realized in New York State in economic development and the achievement of clean air and water far outweigh the additional tax revenues to be gained from the elimination of this program.

I would say parenthetically that the State, and indeed the national emphasis now in hazardous waste management depends much on trying to get small business and industry to try to reduce hazardous waste regeneration, to recycle, use and exchange hazardous waste.

We have an active program in New York State, and probably the most frequent request we get for assistance is in the financing area. We are not doing any financing now with respect to hazardous waste, but we expect within the next few years there will be a tremendous demand in connection with small- and medium-size industry with respect to hazardous waste.

In summary, New York State is aware of the need to control governmental deficits and to plug tax loopholes but we do not believe that Treasury ruling 81-216 or limitations on pollution control financing is an effective way to accomplish these goals. We

believe it would be counterproductive to the current national drive for reindustrialization and a heightened competitive position worldwide to revoke economic stimulants such as revenue bonds.

We believe that abuses in the IDB program should be eliminated but any new restrictions placed on the uses of IDB's should be directed specifically at these abuses and should not cripple the underlying program itself. It is my sincere hope that the IDB program will be refined to eliminate abuses from the program and that Treasury ruling 81-216 will be withdrawn. This will allow small businessmen who depend on this low-cost financing to obtain affordable capital for both economic development and pollution control projects.

Mr. BEDELL. Thank you, Mr. Curran.

Our next witness is William C. Elliott, executive director of Ohio Air Quality Development Authority.

Do you have somebody else with you?

Mr. YOUNG. Yes, I am Jim Young, deputy executive director of the Council of Pollution Control Financing Agencies, of which these three gentlemen are all active members.

Mr. BEDELL. You may proceed, Mr. Elliott.

TESTIMONY OF WILLIAM C. ELLIOTT, EXECUTIVE DIRECTOR, OHIO AIR QUALITY DEVELOPMENT AUTHORITY, ACCOMPANIED BY JAMES YOUNG, DEPUTY EXECUTIVE DIRECTOR, COUNCIL OF POLLUTION CONTROL FINANCING AGENCIES

Mr. ELLIOTT. I am William Elliott, assistant director of the Ohio Air Quality Development Authority. Together with the Ohio Water Development Authority, our two State agencies are the sole issuers of tax-exempt pollution control revenue bonds in Ohio. In 1980, our State led the Nation in recorded pollution control financings.

The reason we make such use of tax-exempt pollution control revenue bonds is because Ohio has a wide range of industrial activity needing abatement attention. The air authority, alone, has financed $1 billion worth of industrial pollution abatement projects. And we have another $1.5 billion in financings awaiting issuance.

Ohio's utilities, steel companies and large manufacturers have been the traditional users of the pollution control revenue bond program. But Ohio's industrial diversity includes a great variety of smaller companies, subject to the same pollution abatement mandates as their larger neighbors, yet facing quite different financial realities. For these businesses, the installation of nonproductive pollution control facilities without access to the public capital markets may mean the difference between staying in business and closing down.

It is Ohio's belief that the single most effective weapon in the fight against pollution is the availability of financing at reasonable cost. We have been very active in the Small Business Administration's pollution control guarantee program which attempts to ease some of the financial burden these companies face in trying to meet compliance commitments.

To date, our financing authorities have provided $35 million in tax-exempt revenue bond financing for 23 small Ohio companies employing over 1,500 people—32 other companies are in the proc-

ess of securing this means of financing for their pollution control projects.

A closer look at these companies reveals a great deal about the problems they face and the avenues of opportunity available to them in their environmental compliance efforts. Of the 23 Ohio companies making use of SBA guaranteed bond issues, all but 5 were part of aggregate issues. This ability to combine several using companies into a single marketable package bond issue is the key to the success of the small business financing program. Otherwise, the front-end costs of bond issuance and relatively low project dollar amounts would make most of these smaller project financings impossible.

Because of the fundamental role played by the aggregation of several small projects into one, more attractive, issue, IRS revenue ruling 81-216 would effectively eliminate small business pollution control financing. There are simply few other places a small company can turn for the financing of large, nonproductive assets.

The impact on Ohio's small businesses struggling to meet congressionally imposed environmental mandates of the removal of umbrella pollution control revenue bond issues is best illustrated with two cases.

Diamond Shamrock Corp. owned a cement plant in Middlebranch, Ohio, that was a major source of particulate emissions. Rather than spending the funds necessary to control the pollution, Diamond Shamrock chose to close down the plant causing the loss of 175 local jobs.

The SME Co., of Uniontown, Pa., purchased the cement plant and analyzed two alternatives for its use. The first, and preferable, choice was to somehow raise the pollution control dollars, install the equipment and reopen the plant. The second alternative was to sell the plant to a Moroccan concern and move it to that country.

The Ohio Air Authority was able to arrange affordable financing for SME as part of a combined, SBA guaranteed, tax-exempt bond issue. The plant was reopened and the 175 jobs restored to the Middlebranch economy. SME's bank was only able to offer financing of such high-interest rate and short maturity for the nonproductive control equipment, that the company had no choice but to look elsewhere.

The SME example is the story of one company. But there are whole small industry groups in Ohio facing disaster from this combination of high financing costs and environmental regulations. Perhaps the most important of these is the electroplating industry centered in Cleveland.

Plating operations typically discharge heavy metal residues that can wreak havoc with municipal sewage treatment plants. U.S. EPA has developed new regulations that call for the treating of this waste before it gets to a public sewer system.

There are more than 100 plating shops in Cleveland employing about 2,500 persons, 90 percent of them inner-city minorities. These shops are small and are hard pressed to replace productive process equipment, let alone the expensive devices needed to comply with the wastewater pretreatment regulations.

But Cleveland's platers are working hard at a creative solution to their problem that will involve relocating many shops around a

central treatment facility. The lynchpin in Cleveland's hopes of saving their electroplating industry is the availability of composite issues of pollution control bonds to help finance their plan.

If aggregated bond issues are not available, the impact will be devastating. The next financing alternative to pollution control bonds would be an SBA grant program. At a 50-percent higher cost to the platers even with the SBA grant, many would have to close down. If that program cannot meet the demand, conventional financing is the only remaining alternative.

The small platers would have to increase the amounts borrowed by 100 percent and pay 4 to 6 percentage points more in interest rates—80 percent of the platers could not afford the nonproductive waste treatment equipment at such costs and would be forced to close opeations. Such a disastrous result can be avoided if the ability to combine loans remains in effect.

In summary, Ohio is very disturbed about this threat to our small business pollution control financing program. We believe Congress, and not the IRS, should decide if any modifications in the industrial bond program are warranted. Our small businesss should not be denied equal access to capital in such perilous economic times. We urge you to consider the impacts on these small companies and their communities in your deliberations on this matter.

I thank you for this opportunity to appear, and would be glad to answer any questions.

Mr. BEDELL. Thank you, Mr. Elliott.

Mr. YOUNG. I would simply say that the council in the whole in its policy has adopted a position of very strong support for the SBA program and one for the recent action of this committee to increase the authorized level of that program, and the council itself is willing to lend any assistance and offer any help that you may require.[1]

Mr. BEDELL. Thank you.

I will start with you, Mr. Elliott. You say of the 23 Ohio companies making use of SBA guaranteed bond issues, all but 5 were part of the aggregate issues.

The testimony primarily has to do with the opportunity to bundle the industrial revenue bond issues. You indicate here, if I understand this correctly, that a requirement as well, in order for this to operate, was that they had the SBA loan guarantee.

Without the SBA loan guarantee, but with the opportunity to bundle the revenue bond issue, would those people have been able to get the financing they needed?

Mr. ELLIOTT. Probably not. The guarantee provides the marketability to the issue. If the Federal guarantee is not in place, the chances of these small companies without public credit ratings and unknown risk involved would not have marketable issues to present to the public.

Mr. BEDELL. Would either of the other two of you agree or disagree with his statement?

Mr. CURRAN. I would agree, Mr. Chairman.

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[1] See appendix B for statement of the Council of Pollution Control Financing Agencies.

Mr. BEDELL. You have to have both the opportunity to bundle the industrial revenue bond issues and have them tax exempt plus have the SBA guarantee in order for the program to operate?

Mr. PATTERSON. That is true for small companies.

Mr. BEDELL. So, you do all agree then that you have to have both of them.

Now there are some other programs.

Are any of the other programs such that they could meet any of these needs in your opinion? You indicated apparently that there was really no other alternative?

Mr. ELLIOTT. I did refer to another SBA grant program. It is my understanding that program is the 503 SBA program, and I am not familiar with it, but the person in Cleveland that I talked to about the electroplating situation said that the program really could not handle the companies and the size of the situation that they do have there.

Mr. BEDELL. We can ask the SBA about that.

Mr. PATTERSON. That is our understanding also in Massachusetts. My understanding is that the 503 program, I believe, is only going to be $200 million nationally. Industrial revenue bonds have a volume of $8 to $9 billion; to give you an idea of what the gap would be to fill. The SBA, in my opinion, is not going to be able to fill the gap if IRB's are terminated.

Mr. BEDELL. One of you said $700 million would be the revenue loss in 1986.

Mr. PATTERSON. That is the estimate on page 45 of the CBO report as to how much revenue the Treasury would gain and have to spend on other items were they to eliminate IRB's as of July 1, 1981.

It is adjusted for the investment effects. They did take cognizance of the fact that if you cut a program like this at high interest rates, you are going to get less investment, and that means less gross national product and salaries and taxes, so they adjusted for the decreased tax revenue that you would get, and they got a net saving of $700 million.

Mr. BEDELL. We are really talking about two things. One thing we are talking about is the investment needed for pollution control equipment which does not increase productivity but does take capital out of companies, so that capital is not available for investment in increased productivity; and the other thing you are talking about with the IRB issues, is where there would be investment for increased productivity; are you not?

Mr. PATTERSON. I directed my remarks at both programs and talked a good deal about the industrial revenue bond, because I see them as linked, and the Treasury has linked them. Revenue ruling 81-216 links them also, affects them both in a devastating manner.

Mr. BEDELL. The purpose of this hearing is to get information out, of course, but I would take it that what you are saying is that we are mandating that businesses have to meet certain pollution control requirements, that that takes capital in order to do so, and that it is more difficult for a small business to get that capital than it is for a large business to obtain such capital.

If they do have to drain their capital in order to do that without the financing methods that have been previously available, then

surely it will deplete, if they can still stay in business, it surely will deplete the amount of money they have available for investment, for increased productivity.

Apparently most innovation comes from small business and job creation comes from small business. If we are going to starve them from the capital they need, it is kind of hard to believe that that is supply-side economics based upon increases in productivity.

Is that true?

Mr. PATTERSON. I wouldn't disagree with a word of that.

Mr. BEDELL. Well, we certainly appreciate your interest.

Staff?

Mr. ROSENBERG. Is it your perception that there is a continuing need for pollution control financing, or is this a maturing situation?

I suppose any of the members of the panel could answer that.

Mr. PATTERSON. From our perspective in Massachusetts, it is just beginning. The water pollution control laws are going to be very severe. We used to be a major tanning center, and the tanneries are already up in arms about what they are going to have to do, and the electroplating is a very, very large business, and as I understand it, they have not put out the standards yet for the electroplating business either.

We think that the potential financing needs are enormous.

Mr. YOUNG. Electroplaters and leather tanners are really the first to belong.

It is probably consistent with the way small businessmen operate, that they are not yet themselves aware of the demands upon them outside of these two particular industries for which specific standards have been issued; but as you go down the list in both air and water enforcement, you will find increasingly small businesses coming under the thumb of the enforcement activities.

Mr. ROSENBERG. Your expectation is that there will be a steady, if not dramatic, increase in the need for pollution control financing assistance at the same time that these curtailments in the Federal programs are occurring, correct?

Mr. YOUNG. There is no expectation that amendments to either the Clean Air or Clean Water Acts will, in any way, deflect this from the course we see.

Mr. PATTERSON. Furthermore, it will continue at the State level, even if the Federal standards are backed off.

The papers are reporting trace metals in the drinking supply, and it has to be cleaned up, no matter what the politics are, and it will cost money.

Mr. BEDELL. Minority staff?

We sure appreciate your testimony.

It is a difficult situation.

The chairman of the committee has some very strong opinions, but those do not necessarily prevail.

Certainly, small business is the strength of our society, and to ignore it seems to me to be very counterproductive at a time when we are trying to increase productivity.

We appreciate your testimony.

We now have some witnesses from the Small Business Administration. We call Edwin T. Holloway, Acting Associate Administrator.

I guess you have some other members with you, Mr. Holloway. Would you introduce them, please?

TESTIMONY OF EDWIN T. HOLLOWAY, ACTING ASSOCIATE ADMINISTRATOR, SMALL BUSINESS ADMINISTRATION, ACCOMPANIED BY VINCENT A. FRAGNITO, CHIEF, POLLUTION CONTROL FINANCING DIVISION, AND PETER F. McNEISH, DEPUTY ASSOCIATE ADMINISTRATOR FOR INVESTMENT

Mr. HOLLOWAY. I am accompanied today by Peter McNeish, Deputy Associate Administrator for Investment, and Mr. Vincent Fragnito, chief of the pollution control section.

Mr. BEDELL. You may proceed.

Your entire statement will be made part of the record.

Mr. HOLLOWAY. Thank you, Mr. Chairman. I believe it is brief enough that I can read it quickly.

We are pleased to have this opportunity today to discuss the Small Business Administration's pollution control financing guarantee program.

Public Law 94-305, passed in 1976, authorized the SBA to guarantee 100 percent of the payments due from eligible small businesses under qualified contracts for the planning, design, financing or installation of pollution control facilities or equipment. The program was designed to allow small businesses to obtain access to the municipal bond markets. This would put them on a more equal footing with their large competitors, who are already able to receive favorable rates and terms for their pollution control financing.

Under the program small business concerns are now able to obtain access to an existing supply of funds which were not previously available to them.

Over 200 small business concerns have utilized the tax-exempt bond financing SBA guarantee program. The process begins when a public entity issues tax-exempt pollution control revenue bonds. The term of repayment of the bond is typically 20 to 25 years. The business enters into a contract with the issuer of the bonds stipulating that periodic payments in sufficient amounts to cover the interest payments to the bondholders and to redeem the bonds as they mature will be made by the small business. The ability of the small business to comply with the terms of this contract is guaranteed by SBA.

Small businesses, because of their limited size and lack of investor recognition in the market, have not been able to obtain tax-exempt financing. The SBA guarantee of the contract between the small business and the issuer provides that recognition. As a result, eligible small businesses can obtain financing in the same manner as corporate giants. In this system that I am describing, the SBA's guarantee role is an add on to the existing system of the municipal bond financing. While the SBA retains the authority for final credit approval, it neither regulates the market nor determines which business loans come into being.

The private sector operates this unique marketplace. This market consists of large and small commercial banks and investment bankers; bond buyers such as insurance companies, banks and individuals; and intermediaries such as bond traders. Through the SBA pollution control financing program, small businesses are added to this market as participants who can enjoy the favorable financing terms and rates previously available only to large firms.

Under the program, bond financing is available on terms up to 30 years at competitive rates. Up to $5 million per small business may be obtained through this bond financing method.

During its nearly 5 years of operation the program has assisted 213 companies. Through fiscal year 1981 the amount of principal that SBA has guaranteed totals $256 million. Since its inception the program has experienced only two defaults, which resulted in $66,000 of payments from the reserve fund. In these cases, our collateral position and the workout agreements with the companies indicate that no losses will occur.

On an annual basis, the program has grown considerably since its inception. In fiscal year 1977, 12 companies were assisted for a total principal of $5.7 million; in fiscal year 1978, 14 firms for $9.9 million were assisted; in fiscal year 1979, 45 firms for $41.5 million were assisted; in fiscal year 1980, 77 firms for $98.5 million; and in fiscal year 1981, 66 firms for $99.9 million were accommodated through the program. There are currently outstanding, 55 commitments to be closed totaling $91.2 million in principal. Additional applications from 47 companies totaling $77.8 million in principal have been received and are being processed. Further, a recent informal polling of many underwriters and bond issuing authorities active in the program reveal that 151 applications totaling $210 million are being processed for submission to SBA under the program.

The program was designed to be, and is, self-sustaining. Although Congress appropriated $15 million in 1976 to cover losses, this amount has never been needed and still remains available. In addition, through September 30, 1981, fees in excess of $20 million had been collected to cover any losses that might be experienced. This provides a total loss reserve of over $35 million including interest earned on the amounts collected. The probability of losses is minimized by the overall stringent credit criteria, the eligibility requirements of the program and the high levels of cooperation between the public and private sectors in implementing the program.

This program has proven to be of significant merit in meeting the needs of the small business community in pollution control financing.

Mr. Chairman, this concludes my prepared remarks. I will be pleased to answer any questions that you may have at this time.

Thank you.

Mr. BEDELL. Thank you very much, Mr. Holloway.

Do either of your assistants have any comments to make?

I appreciate your testimony. First of all, it seems to me your testimony indicates this has been a most successful program and has been of great help to people who would not otherwise have

been able to get the financing they needed for some of these programs.

Mr. HOLLOWAY. It has clearly been effective in accomplishing what it was designed to do; that is, to give a subsidy interest rate to borrowers who need to install pollution control equipment.

Mr. BEDELL. But the subsidy interest rate, there is no Federal subsidy involved; is that correct?

Mr. HOLLOWAY. Well, the Federal subsidy that is involved is only in the sense of the loss of revenues to the Treasury through the bonds being tax exempt.

Mr. BEDELL. You are talking about the tax-exempt bonds. As far as the small business program, your loan guarantees——

Mr. HOLLOWAY. As far as the small businessman is concerned, he gets a lower rate of interest.

Mr. BEDELL. As far as the SBA program of loan guarantees, if I read your testimony correctly, your testimony indicates there have been no losses, and certainly there is no cost to the Treasury of those loan guarantees. Is that correct?

Mr. HOLLOWAY. There is no subsidy, Mr. Chairman, other than the interest rate subsidy.

Mr. BEDELL. There is no interest rate subsidy in the small business program. So there is no subsidy involved in your SBA loan guarantee program.

Mr. HOLLOWAY. Mr. Chairman, there is no direct subsidy involved. I think there is a point to be made that because of the loss of revenue to the Treasury, in effect a subsidy is provided through the program.

Mr. BEDELL. But that is not your program. That is another matter, which is whether or not there will be industrial revenue bonds, tax-free bonds available. Is that correct?

Mr. HOLLOWAY. Yes, sir, that is correct.

Mr. BEDELL. It seems to me that in addressing this issue, as far as the SBA is concerned, the issue has to do with what the SBA program will be and how it will operate and be funded——

Mr. HOLLOWAY. Right, sir.

Mr. BEDELL [continuing]. And what the costs will be. OK?

Mr. HOLLOWAY. Surely.

Mr. BEDELL. I take it from what you say here in your testimony, it says, "This will put them on footing with their large competitors." So I take it your testimony is that this program has made it possible for the small businesses to compete on a more equal footing.

Mr. HOLLOWAY. That is correct.

Mr. BEDELL. "As a result, eligible small business can obtain financing in the same manner as corporate giants."

Mr. HOLLOWAY. That is correct.

Mr. BEDELL. And apparently there have been no losses. You have had two failures, but assets are such as to cover any of your losses. So there have been no losses in the whole program.

Mr. HOLLOWAY. That is correct. There have been no losses.

Mr. BEDELL. And apparently, as you outline so clearly, there has been an increase starting in 1977, $5.7 million; 1978, $9.9 million; 1979, $41 million; 1980, $98 million; and so on.

In 1981, it stayed about the same as in 1980. Was that because of a lack of demand for those loans or was that because of limited money available, or why was it?

Mr. HOLLOWAY. The final figure that would be available as a program level was not really nailed down until late in the year. There was additional demand. There were additional requests in the pipeline that would have resulted in a higher program level had that been authorized.

Mr. BEDELL. You mean it was not authorized by the Congress?

Mr. HOLLOWAY. Authorized and apportioned by the OMB.

Mr. BEDELL. So the reason there was not very much of an increase in 1981 over 1980 was because OMB did not permit you to make those guarantees.

Mr. HOLLOWAY. That is correct.

Mr. FRAGNITO. Mr. Chairman, the total amount authorized for fiscal year 1981 was $180 million. That is approved, committed transactions.

Mr. BEDELL. By the Congress?

Mr. FRAGNITO. By us. We had applications totaling $180 million that we could have used for fiscal year 1981.

Mr. BEDELL. And OMB would not let you do it?

Mr. FRAGNITO. We had authority allocated by OMB at the $100 million level.

Mr. BEDELL. What did Congress authorize in 1981, do you know?

Mr. FRAGNITO. I believe it was $110 million.

Mr. HOLLOWAY. It was $110 million, but in conference the number became $100 million.

Mr. MCNEISH. I might add one more fact. Very late in the fiscal year, the Congress did make an adjustment to I believe it was either $150 million or $160 million. But from a program management point of view, it was impossible at that juncture—it was in the last few weeks of the fiscal year—it was impossible to manage those funds, to put them into effective transactions.

Mr. BEDELL. Why was that? You had the loans. You had approved them.

Mr. MCNEISH. There is a fairly complex closing process that involves all the parties to the transaction that could not be accommodated in a few weeks' time.

Mr. FRAGNITO. It takes 6 to 8 weeks from the time you set a closing date to accomplish a closing. To be very honest, we only have a staff of three people, so it would have been impossible for us to utilize any increased amount.

Mr. BEDELL. I need to understand the problem. Your testimony is that Congress only approved, authorized $100 million. Is that what you are saying?

Mr. MCNEISH. I believe it was $110 million, up until very late in the fiscal year. They made an adjustment.

Mr. BEDELL. When was that adjustment?

Mr. MCNEISH. In September.

Mr. FRAGNITO. Early September.

Mr. MCNEISH. Which is the last month of the fiscal year.

Mr. BEDELL. So then you have quite a backlog, I assume, from those that you were unable to process in 1981. Is that correct?

Mr. FRAGNITO. I believe Mr. Holloway gave you the numbers in his statement. The backlog at this point is $92 million, roughly, of the committed transactions, ready to be closed, against the present continuing resolution we are operating under of $95 million.

Mr. BEDELL. That is what we need to find out. So in 1982, according to current legislation, you are limited to $95 million. Is that correct?

Mr. FRAGNITO. I believe the legislation calls for $250 million.

Mr. HOLLOWAY. But we have no appropriation, no final appropriation bill yet, Mr. Chairman. So we are on the basis of just continuing at the same rate as our spending last year.

Mr. BEDELL. There would be no appropriations bill, would there, on loan guarantees?

Mr. HOLLOWAY. But there is an authorized program level that is passed into law.

Mr. BEDELL. Which was $250 million; is that correct?

Mr. FRAGNITO. Yes, sir.

Mr. HOLLOWAY. I believe that that is——

Mr. BEDELL. That bothers me, Mr. Holloway. You act like you don't really know.

Mr. HOLLOWAY. It is a little unsure at this point, Mr. Chairman, until we get a final bill that is passed by both the House and the Senate, signed by the President, and the authority is apportioned to us by the OMB.

Mr. BEDELL. Are you telling me you don't have a bill passed by the House and the Senate and signed by the President authorizing $250 million?

Mr. HOLLOWAY. That is my understanding, Mr. Chairman.

Mr. BEDELL. Is that your understanding?

Mr. FRAGNITO. No, it is not, sir. My understanding is that the level authorization, in the reconciliation budget, is $250 million.

Mr. BEDELL. It is pretty important, in your position, that you should know whether you have authorization for $250 million.

Mr. HOLLOWAY. Yes, sir. It is my understanding at this point we do not have full final legal authority to operate the program beyond the level at which it was operated last year.

Mr. BEDELL. We are talking about two different things. The Congress has authorized and the President has signed, if I understand it correctly, legislation authorizing $250 million. Apparently you did not think that was the case.

Mr. HOLLOWAY. I do not believe that the complete process of apportionment of that authority to us from the OMB has been completed.

Mr. BEDELL. That is a different story, what OMB is doing.

We have the legislative branch and the executive branch. The legislative branch, if I understand correctly, has authorized $250 million for this program. The President has signed such authorization.

Mr. HOLLOWAY. That is correct.

Mr. BEDELL. It is kind of silly for us to have a congressional hearing, Mr. Holloway. I don't mean to be rude, but to explain to you what has happened, if you are in charge of it, it seems to me it is critical. I am just shocked to death we would have somebody

with your stature come before this committee and not know what the situation is.

Mr. HOLLOWAY. I would like to call on Mr. McNeish to explain the problem with us going forward at this point and making actual commitments at the level of $250 million.

Mr. BEDELL. That is great. I think we should. I would hope we won't always have to have congressional hearings for the people in charge to understand what the situation is, Mr. Holloway.

Mr. MCNEISH. Your statement is correct, Mr. Chairman, in terms of the authorization by the Congress. It has been signed into law by the President. The blockage point at this point in time in terms of effective apportionment or usage of those funds is in discussions at the level of OMB and the White House, and the question of their posture on Federal credit programs generally, which you alluded to in your opening statement, and the question of what approach the administration will take in recommending reduced levels in terms of budget cuts on a number of Federal credit programs, including this one.

In this interim period, we have only an authorized level, as Mr. Fragnito indicated, from OMB to utilize funds at this juncture to the extent of $40 million for the first quarter of this fiscal year.

Mr. BEDELL. So the reality of the situation is that Congress has passed and the President has signed legislation authorizing $250 million; that you have requests outstanding of slightly over $91 million that you were unable to fill last year, $77.8 million of additional applications, and a survey indicates there is $210 million also in the pipeline, for a total of $379 million, which significantly exceeds the $250 million authorization; and that even though Congress passed it and the President signed it, OMB has told you that you cannot guarantee over $40 million of that.

Mr. MCNEISH. You are missing one fact, Mr. Chairman; that is, the administration has also submitted to the Congress recommendations for budget cuts in this program reducing the program to the $95 million.

Mr. BEDELL. Sorry. I did not mean to leave anything out. But as things stand, the President signed such legislation and OMB has told you you cannot spend it, even though the President signed the bill.

Mr. MCNEISH. In light of the President's recommendation to reduce the program levels, that is correct. It would seem foolhardy to manage a program at a $250 million level if the President intends to reduce the program to $95 million.

Mr. BEDELL. You have complete freedom. If OMB had not said that, you could go right ahead and issue loan guarantees.

Mr. MCNEISH. The SBA does not have complete freedom on budget matters without OMB. It is a decision by this administration.

Mr. BEDELL. They signed the bill.

Mr. MCNEISH. They have subsequently made a recommendation to reduce the program level through budget reductions to the level of $95 million.

Mr. BEDELL. I guess we really get to the real issue of who it is that makes the determinations about where money is to be spent. At least most people think that Congress makes that determina-

tion, with the approval of the President, and the President had signed and agreed to this.

Mr. McNEISH. Obviously, but that is ever-changing and not locked into stone. The President certainly did take that action. He has subsequently taken additional action. He has come to the Congress and asked them to reconsider the position.

Mr. BEDELL. Further than that, this has no effect upon the budget. Is that correct?

Mr. McNEISH. Well, I will go back to Mr. Holloway's point. There is an implicit effect upon the budget because of the tax exemptions.

Mr. BEDELL. No.

Mr. McNEISH. Yes.

Mr. BEDELL. The IRS has already ruled they cannot use the tax exemption; is that correct, or is that incorrect?

Mr. McNEISH. Well, their ruling would propose to do that, yes, sir.

Mr. BEDELL. So that the bonds would not be tax exempt under current rulings. So there would be no cost to the Government; is that correct?

Mr. McNEISH. So long as we did not suffer any losses, that is correct.

Mr. BEDELL. You have not suffered any losses so far.

Mr. McNEISH. No.

Mr. BEDELL. Can you understand the frustration we have here in Congress trying to operate in a manner that would help us to solve our national problems?

Mr. McNEISH. It is not simply a matter of cost, Mr. Chairman. It is also a question of the administration's general policy with Federal credit programs, the impact they have on the credit markets and generally on interest rates across the board nationally, and the impact on inflation, which I think we are all jointly trying to get a handle on.

Mr. BEDELL. Are you through?

Mr. McNEISH. Yes, sir.

Mr. BEDELL. The administration's policy is that we should let big businesses sell their tax credits to other big businesses at a loss of $27 billion of tax revenue over the next several years, but that we should not do something that is not going to have any impact on cost to the Federal Treasury in order to help small businesses meet their requirements for pollution control equipment.

Mr. McNEISH. That is your characterization, sir, not mine.

Mr. BEDELL. How would you characterize it differently?

Mr. HOLLOWAY. Mr. Chairman, you referred in your opening remarks to the fact that inflation and high interest rates have driven up the cost of these facilities, and indeed all other facilities. High interest rates adding into the cost of almost everything is certainly one of the No. 1 issues that need to be addressed.

There is little question but what Government borrowing, Government lending, Government guaranteeing, are making the Government the largest user of the pool of credit and leaving such a small amount that the users of the remainder are bidding up the interest rate.

So, it is really a catch-22. The interest rates drive up the inflation, and the attempts of the Government to have programs that

will address the causes of inflation and to assist people such as users of tax exempt revenue bonds, uses up the available credit. It is just a vicious cycle.

So I think much of our conventional wisdom is being called into question. These issues are being examined in a more macrosense.

Mr. BEDELL. I presume you would think it is macrosense to say that we are going to let big businesses sell their losses to other big businesses, reducing the revenues by $27 billion over a 3-year period.

Mr. HOLLOWAY. I am not attempting to defend, Mr. Chairman, any tax policies or things of that nature that are outside really the direct concerns of our lending programs.

Mr. BEDELL. Well, you have already said, however, that you feel high interest rates are the problem, with which I agree, but you are supposedly here representing small businesses. It seems to me we have to concern ourselves with——

Mr. HOLLOWAY. Mr. Chairman?

Mr. BEDELL. If I may finish, if you please would not interrupt me until I finish, then I will promise not to interrupt you, sir.

It would seem to me that if we are concerned about small business—which has been documented as furnishing most innovations, which has been documented as furnishing most of the new job creation—that for us to say that we are not going to make loan guarantees to those small businesses in order that they can help get the financing, which you testify would make it more equal with big business, and which would not of itself cost the Government money, but that we are going to let big businesses sell their tax losses to other big businesses at a cost of $27 billion to the Treasury over 3 years, is of significant concern to small business.

If you feel that in your job in trying to help small business this is something that has no relevancy to you, that you should not be concerned about, then I have to tell you I just don't understand your thinking, Mr. Holloway.

Your turn.

Mr. HOLLOWAY. Mr. Chairman, my point is that at some place there is a balance as to how much assistance can be given. For example, when, because of Government intervention, one small business gets a loan that he would not otherwise have gotten but for that Government intervention, there is somewhere a small business that was crowded out and did not have an opportunity to get that loan.

Mr. BEDELL. Are you through?

Mr. HOLLOWAY. Yes, sir.

Mr. BEDELL. What a crazy argument. We just had $5 billion, as I understand it, that Mobil has offered to pay in order to buy Marathon Oil Co. You are saying that it is the loan guarantees that you make to these small businesses that are crowding small business out.

Certainly it is these other things, the size of the Federal deficit, all of these things.

If the Small Business Administration believes that the reason small business cannot get loans is because other small businesses are getting those loans, then for crying out loud, somebody better

do something about what the attitude is over in the Small Business Administration.

Mr. HOLLOWAY. Mr. Chairman, no position has been taken or is intended to be taken that the crowding out issue is related to small business lending only. Small business lending perhaps may be a very small part of it.

I was merely intending to make the point that Government borrowing, Government lending, Government guaranteeing in all of its forms is a part of the problem that needs to be examined.

Mr. BEDELL. Well, it is just so frustrating, frankly, for me as a member of Government who believes that we need to address our problems, to sit here and see the Small Business Administration people coming here testifying in a manner in which they do.

It was the Government that said we had to have these pollution controls and these requirements. I do not object to that, but then for the Government to say that that ought to have bottom priority—for the people from SBA to be here testifying that indeed they think it is fine, not to try to do what Congress originally passed, what the President signed, what OMB has told you, you cannot do, I don't really know if there is a great deal of sense in having a Small Business Administration if they are not going to give a darn about small business.

Maybe that is unfair, Mr. Holloway. First of all, you didn't understand the program, as I interpret what was said, as to what had happened. Then we defend it because of the fact we say if we give a loan to some business firm it is going to crowd out another small business firm. To me, that is a ridiculous argument, when all small business is having great difficulty.

The fact of the matter is it does little good for you and me to argue because I know you are not the one making the total policy within the administration, but for God's sake, somebody better get the word out at least to the public that what we have is an administration that is furnishing $27 billion in tax breaks for big business and is not willing to make loan guarantees to small business, which doesn't cost the Government any money.

Somebody better get the word out, because I believe there are a lot of small business people that ought to at least know it. I believe if our economy is going to be healthy, then we better do something to bring fairness to our economy.

I don't think it has ever been fair, but my God, it hasn't been as unfair as it is under the policies that seem to be addressed at this time by the administration.

To have the Small Business Administration's people come here and say this is just great, the program is working wonderfully, it has brought some equity, some fairness, and then to say don't worry about it, we have a lot of excuses as to why we are not going to make the loan guarantees, even though they don't cost us any money, this is just beyond my comprehension.

I think I am kind of speaking to the winds here. I have no further questions.

Mr. Molinari?

Mr. MOLINARI. No questions, Mr. Chairman. I just arrived.

Mr. BEDELL. Maybe you are lucky.

Mr. MOLINARI. I was very impressed by what you had to say at the conclusion of your remarks. We will save ourselves for a later time.

Mr. BEDELL. I have nothing further.

Mr. Hiler?

Mr. HILER. I have no questions. I just walked in as well.

Mr. BEDELL. Mr. Rosenberg?

Mr. ROSENBERG. Mr. Chairman, a question arises, with previous witnesses from three different States testifying in full agreement that their projection was there would be a significant, if not dramatic, increase in demand for pollution control financing assistance to small businesses, and their testimony being quite clear that they believe that many of the small businesses with which they deal will not be available to stay in business, and certainly would not be able to finance any expansion in the coming years if they are not able to obtain some Federal guarantees and assistance in financing. The question arises as to whether SBA will be able to recommend any alternative course to those small businesses if there is no additional financing available through this program or industrial revenue bonds.

I am wondering if the gentlemen at the witness table would be able to offer any suggestions as to whether there are any alternatives available to these small businesses and what they might be.

Mr. HOLLOWAY. The only viable alternative insofar as a SBA program is concerned would be assistance under our regular business loan program through the guarantee route. However, that would not provide the lower rate for the borrower that is available under the pollution control guarantee program. It would be a market rate.

Mr. ROSENBERG. Are we not under equally strenuous constraints as to how much money is available under that program in the current budget?

Mr. HOLLOWAY. We are under constraints under the program. The total amount of program level will be somewhat smaller.

Mr. ROSENBERG. Well, now, you are confining yourself just to the SBA. If a business comes to you and says, as the previous witnesses indicated, that they are going to be forced out of business if they cannot get some assistance from the Federal Government to meet pollution control compliance costs, and they come to the Small Business Administration seeking assistance—and you are now not only full up to your OMB-directed limit, but you are oversubscribed as far as people waiting in line to get financing—where do you send them, what do you tell them?

Mr. HOLLOWAY. Well, there is really no alternative program that I am aware of to meet that need. The point that I thought should be surfaced was that high interest rates is the biggest problem, and if the interest rates can be gotten down, then many, many businesses who cannot make it at 22 and 23 and 24 percent can, without Government assistance, through the banking community.

Mr. BEDELL. Any other questions?

Mr. KULIKOWSKI. Getting back to the funding level—I just wanted to clarify one point concerning the appropriations process. I think everyone has agreed there is an authorization level in effect. There is also a House appropriations bill that has been passed.

In the report on that bill, I believe the Appropriations Committee states that it expects the Small Business Administration to spend the full amount of authorization. However, there still remain several steps in the process, which is a Senate bill and a conference committee agreement, and then having it passed by both Houses.

It is at least conceivable that coming out of the Senate or coming out of the conference committee or coming out of the action on the floor in both Houses, there could be some action taken which would state that Congress, in accordance with the President's request, would not object if SBA did not spend the full authorization in this program.

If that were to take place, my question is what would be your position when faced on the one hand with an authorization for $250 million and then on the other with an appropriations statement that Congress would not object if you did not spend that full authorization in accordance with the President's request?

Mr. HOLLOWAY. I believe our posture in that case would be to negotiate with the Office of Management and Budget for the apportionment or authority level that we believe to be appropriate. That final decision would be made by our Administrator.

Mr. MCNEISH. I might add, it is my understanding that authorization bills, at least in this case it states that the authorization level is not to exceed $250 million. It is not a mandated expenditure at the $250 million level.

So if there was a second appropriations bill and a stated figure, it would seem logical that the administration would take that as a clear signal from Congress to spend at the lower figure.

Mr. KULIKOWSKI. So there is at least some logic in the position that until the final authorization level is set, that spending go on at a level which is at least in accordance with—which does not obligate the SBA to spend at a figure greater than—what, the final figure is likely to be?

Mr. HOLLOWAY. That is correct.

Mr. KULIKOWSKI. Thank you, Mr. Chairman.

Mr. BEDELL. Anything else?

Mr. ROSENBERG. Just to clarify the record, we are not talking about actual expenditures here. We are talking about issuance of guarantees.

Mr. BEDELL. We thank you very much.

Our next witnesses are Michael E. Gibbons, an investment banker with McDonald & Co., Cleveland, Ohio; David Cordish, Energy Resources, Ltd., Baltimore, Md.; and Michael Cooper, director of equipment and technology programs, National Solid Wastes Management Association, Washington, D.C.

I would ask you to identify yourselves. We will hear from all three of you before we have our questioning.

First of all, we ask for Michael Gibbons.

Mr. Gibbons, you may proceed.

PANEL CONSISTING OF MICHAEL E. GIBBONS; DAVID CORDISH; AND MICHAEL COOPER

TESTIMONY OF MICHAEL E. GIBBONS, INVESTMENT BANKER, McDONALD & CO., CLEVELAND, OHIO

Mr. GIBBONS. Mr. Chairman and members of the committee, my name is Michael Gibbons. I am a general partner and member of the municipal finance department of McDonald & Co.

McDonald & Co. is a regional investment banking firm headquartered in Cleveland, Ohio. The firm has 19 offices in five States with the greatest concentration of offices and staff in the State of Ohio.

McDonald's municipal finance, underwriting and trading operation is generally recognized as one of the foremost regional operations in the United States. Although McDonald & Co. is not among the largest firms in the Nation, in 1979 it ranked 12th among all investment firms in the United States in the number of tax-free bond issues managed or comanaged.

If one were to briefly describe my job, one would say I am active in the financing of projects for all types of businesses. I am actually out there talking with the people that need the funds.

The means I have employed in the past to finance these projects has been exclusively tax-exempt revenue bonds. Over the past several years we have found that if available, tax-exempt revenue bond financing is usually the most inexpensive form of financing available.

In my exposure to the many businesses of all sizes, I am faced with a serious dilemma. Often a small- or medium-sized business with a long history of profitability contacts me to help them with the financing of pollution control facilities. They have heard a great deal about industrial revenue bond financing and want to take advantage of its benefits.

The owners of these small- and medium-sized businesses usually are not aware that currently in only a very small percentage of cases is any form of tax-exempt financing available, and virtually never is it available for financing pollution control facilities; that is, unless they can take advantage of a small SBA program that is in reality only available to a very few.

Tax-exempt revenue bond financing is very often misunderstood by those who seek to use it. Although it has achieved great popularity in recent years, it is still the credit of the company borrowing the money which determines whether or not the bonds can be sold.

A State or local government typically acts as issuer of the bonds, but it is not their credit which is looked to by the bond purchaser. Rather, this governmental entity merely lends its tax exempt borrowing power and acts as a conduit.

The advantage to the borrower comes with the fact that since interest paid on the bonds is not subject to income taxation, the purchaser of the bond is willing to take a lower rate of interest. It is financial commonsense that a lower rate of interest on financing makes more and larger projects viable.

Tax-exempt financing is usually not available to small- or medium-sized businesses for any purpose under current economic conditions. In the past, the purchasers of these small company

bonds were usually only the banks of account of that small company, a service rendered to that company, much like free checking.

As we are all aware, banks are not as profitable today as they were a couple of years ago. Their need for tax-exempt income has therefore been reduced.

Although this was not true in the past, currently most of the banks we are in contact with will not entertain the purchase of any tax-exempt revenue bonds. Although larger companies are facing the same high interest rates as the small, tax-exempt financing is still available to them.

Larger companies usually have more pull with the banks and therefore are still finding some buyers among the financial institutions. Even more importantly, large companies with financial standing sufficient to obtain a credit rating from one of the two major credit rating services can access the public bond market. They can find underwriters, such as McDonald & Co., ready and willing to purchase and underwrite their bond issues for remarketing to their customers, relying only on the strength of the underlying credit.

If a small business can't obtain tax exempt financing for a highly lucrative expansion right now, imagine how difficult it is for them to finance pollution control equipment.

Pollution control equipment usually does not add to net income. Often its operating cost of the equipment detract from profitability. If that is not bad enough, it usually has little or no value to anyone other than the users. It offers a lender very little collateral value.

Consequently, the small business is forced to look to short-term high interest rate loans from conventional lenders, usually their bank. Often they are forced to make large cash downpayments, further depleting their working capital.

One additional negative aspect is since the equipment has little collateral value, the bank making the loan looks more carefully at the strength of the company itself. Since small companies usually have limited borrowing power, this pollution control loan will cut into their available credit. Expansion capital will be limited.

The full impact of financing equipment to meet environmental regulations cannot be appreciated unless one realizes the scope of these requirements.

Virtually every electroplater in the Nation faces stiff compliance schedules over the next 2 years. There are some 9,000 job shop electroplaters across the Nation employing on average 15 to 20 people apiece.

Most of the platers I have been involved with have net worths of less than $400,000 and are faced with the purchase of equipment of from $300,000 to $500,000. They must finance—and I want to emphasize this—up to the full amount of their net worth of the company for equipment that will not add a dime to their bottom lines.

The electroplater is just one of the many industries which face similar problems. The low margins, high capital costs and impact of compliance schedules, which vary from city to city, combined with equipment requirements, are forcing and have forced many of them out of business.

I might point to the hypothetical electroplater's financial alternatives example on page 7 of the written material I have handed out to show the impact of a typical equipment financing on the average electroplater.

A solution does exist for the small business faced with high equipment costs for environmental compliance, at least a partial solution. The SBA pollution control financing guarantee program is in place and has been a savior for the lucky few who have known of it and used it.

I will not speak to the startling level of success from the standpoint of successful loans, as there are others that have already addressed that. However, I will say without hesitation that it presents the only existing alternative for many companies I deal with.

I estimate that a full three-quarters of the 79 companies I now have in process of putting together applications would not have any other means to finance their projects.

The beauty of the program lies in its combination of the public sector and the private sector to produce the most efficient mechanism for financing a problem situation I have ever seen.

A typical industrial revenue bond is issued for the purchase of pollution control equipment. Then a 100-percent guarantee of the SBA and, therefore, the U.S. Treasury, is attached to the repayment of the loan.

The power of combining a tax-exempt bond with a Government guarantee is the only thing that can save many of these companies. The guarantee allows the issue to receive a triple A rating by both of the rating services.

With this kind of security, it is possible to extend the term of the loan out to 20 to 25 years, at a comparably very low rate.

As I show in my example on page 7 of the written material, the reduction in cash needs through extending the term of the loan at these loan rates means survival to my hypothetical company. The tax-exempt bond market by its very nature can effectively receive the smaller sized issues with both retail buyers and some institutions showing interest in purchase.

The public taxable bond market is not amenable to these smaller issues. Most of the issues are large, for very, very large companies. In the past, the issues of a number of companies could be marketed together in order to save costs of issuance. However, since the issuance of revenue ruling 81-216, our ability to do this composite form of financing has been hampered. In fact, it is the very smallest of the companies involved with the smallest loans that will be prohibited from using the SBA program.

In conclusion, I would like to say that I know of no other means to cope with the problem facing small business, if environmental regulations are to be enforced as currently proposed, other than the SBA pollution control financing program.

However, until additional allocation of guarantee authority, authority which already has been legislated, is put in place and sufficient staff is employed to handle processing of the applications, the program can only be available to a lucky few.

Thank you.

Mr. BEDELL. Thank you, Mr. Gibbons.

I notice that in your prepared statement, you varied some of the figures. Do you want your prepared statement entered into the record in its entirety?

Mr. GIBBONS. Yes, I do.

Mr. BEDELL. In addition to your testimony here?

Mr. GIBBONS. I think some of the numbers I used in my oral testimony would fit in with those numbers rather easily. It is just I have taken specific examples.

[Mr. Gibbons' prepared statement follows:]

PREPARED STATEMENT OF MICHAEL E. GIBBONS, GENERAL PARTNER, MCDONALD & CO., CLEVELAND, OHIO

Mr. Chairman and members of the Committee, my name is Michael E. Gibbons. I am a general partner and member of the municipal finance department of McDonald & Company. McDonald & Company is a regional investment banking firm headquartered in Cleveland, Ohio. The firm has nineteen offices in five states with the greatest concentration of offices and staff in the State of Ohio. McDonald's municipal finance, underwriting and trading operation is generally recognized as one of the foremost regional operations in the United States. Although McDonald & Company is not among the largest firms in the nation, in 1979 it ranked twelfth among all investment firms in the United States in the number of tax-free bond issues managed or co-managed.

Purpose of Testimony

It is my purpose in testifying before you to attempt to bring to light the serious difficulties faced by great numbers of small and medium sized businesses in financing required pollution-control facilities. As an individual active in all areas of business financing with tax-exempt bonds, I have come in contact with literally hundreds of businesses faced with the task of purchasing and financing pollution-control equipment.

A great majority of the small businesses have encountered environmental regulations which require the purchase of non-productive assets at costs representing great percentages or even multiples of their net worth. For large publicly held businesses environmental regulation has been burdensome but for many small and medium size companies, without the Small Business Administration Guarantee Pollution Control Financing Program, or programs like it, meeting these regulations would be impossible.

Problems Facing the Small Business Administration Pollution Control Financing Program

The Small Business Administration Pollution Control Financing Program, although highly successful, has had its effectiveness greatly reduced. Although Congress has recently passed on increases in the guarantee authorization to $250 million for fiscal years 1982, 1983 and 1984, this authority has still not been allocated to the program by the Office of Management and Budget. Consequently, huge numbers of applications are sitting idle on the desks of the staff of the Office of Special Guarantees. Many of these applicants are depending on the receipt of guarantee commitments for their very survival.

A recent ruling by the Internal Revenue Service 81-216 has created great difficulties in the packaging of these small company bond issues. Unless the requirements of this ruling are waived, or the ruling revised, it may eliminate tax-exempt financing under this program altogether.

The Office of Special Guarantees is incredibly understaffed. Although the program is essential to literally thousands of small businesses and tens of thousands of their employees, only three persons administer the program.

In my experience each of these people is very capable, very efficient and very willing to help. There are just too many applications for them to handle. The staff must be increased for the program to represent a solution to an applicant's problems.

Problems in Financing for Small Business

In recent years industrial revenue bond financing has achieved great popularity in financing business expansion. If a project meets certain qualifications specified by state or local government, that state or local government can borrow money in its name and lend these funds to a business for its proposed project. The bonds are actually sold to one or more purchasers, usually by an underwriter with the issuer acting as a conduit and passing along the funds to the borrowing company. In each case the underwriter will work with the issuer and the borrowing company to coordinate all aspects of issuance and then will actually buy the bonds for its own account, taking on the market risk associated with such a purchase, and re-offer the bonds to the public.

The interest paid to purchasers of bonds of a governmental issue is exempt from federal income taxation. Therefore, since, "after tax" the purchaser is receiving more than he would if the interest was taxable, the bonds can be sold at a much lower rate of interest.

Although the governmental issuer lends its borrowing power it does not lend its credit. The purchaser of each bond issue looks solely to the credit of the company doing the project. For major publicly-held corporations this often does not pose a significant problem, since their credit may be

acceptable to the investors who make up the publicly traded tax-free debt market. Generally the more financial strength a company has the lower the interest rate its bond will carry relative to other borrowers. However, for small or privately held companies it can often be an insurmountable problem. Often the only market a small company may have for its tax-exempt debt is its bank of account, or in certain very limited cases, a few sophisticated institutional investors capable of analyzing the risks of such an investment. Therefore, the small business does not have the same advantages that the larger business does in obtaining the substantially lower rates of the public tax-free debt market.

In most states pollution-control equipment financing is a qualified use for tax-exempt bond financing. Obviously, if tax-exempt financing is available it is usually the cheapest method of financing this equipment. However, financing pollution-control equipment presents a particular problem and an even greater problem if it is a small business that must borrow. For most lenders the financial strength of a borrower is certainly important but when money is being lent the collateral value of the equipment is also of great importance. The greater the marketability of the equipment the greater a percentage of its cost a lender may be willing to finance. Typically, pollution-control equipment has little or no collateral value. It is most often a very specialized installation useful only to the company that is borrowing for the process that it was designed for.

The implications for financing are obvious. A lower percentage of financing is available on pollution-control equipment, requiring the small business to put up cash. Since the equipment has such limited value to the

lender that lender will often require repayment over a very short period of time. A great burden has been placed on every business in the current economy. Interest rates are at all time highs. But higher rates on loans payable over short periods of time create a serious if not impossible challenge for the small business's survival. As if these burdens are not enough, banks, due to their reduced profitability and consequent lessened appetite for tax-free income, are currently not interested in purchasing tax-free bonds for even their very good small business customers no matter how high a rate or short a term. Thus the prime source of small business low cost credit has been effectively removed.

The Small Business Administration Pollution Control Financing Guarantee Program

The small business has had available, until recently, a solution that did not eliminate its problem in financing pollution-control equipment but certainly did much to alleviate its problem. The solution I am referring to is the Small Business Administration's Pollution Control Financing Guarantee Program. Through a guarantee of the tax-exempt bonds being used by a small business to finance a pollution-control project, the bonds can be sold in the public debt markets.

The bonds are rated AAA by Moody's and Standard & Poor's after the guarantee by the S.B.A. This provides the borrower with an interest rate among the lowest in the tax-exempt bond market. Because the bond is guaranteed the purchaser of the bond looks only to the credit of the United States and not to the credit of the borrower or the collateral value of the equipment. The borrower can therefore obtain financing over an amortization period which more closely reflects the economic life of the equipment rather than the collateral value of the equipment to the lender. In all cases, McDonald &

Company has issued bonds with this guarantee with a twenty year maturity. With the lowest rate available and the longer amortization period the strain on the cash reserves of the small business are greatly alleviated. In many cases in which I have personally been involved the ability of the borrowing company to access this program has meant its very survival and with it the survival of literally hundreds of jobs.

The Necessity of Long-Term Low Cost Financing

Certain types of business have been impacted the most significantly by environmental regulations. Obviously it is these industries whose processes present the most potential environmental damage that have faced the stiffest compliance schedules. The electroplating industry, all types of metal foundries, and gravure printers, to name a few industries, face substantial compliance requirements currently and in the near future. Many of the businesses in this industry group are small shops with less than 250 employees. In the case of the electroplating industry, virtually all the electroplaters I have been involved with have had less than 100 employees - usually fifteen to twenty. There are over 9000 job shop metal finishing firms across the country. Typically these electroplaters have total net worth's of from $350,000 to $500,000 and must finance from $300,000 to $600,000 worth of environmental equipment.

In my experience, with the cash generation capability of a business the size of the typical electroplater I work with, no viable alternative exists to the Small Business Administration Pollution Control Financing Guarantee Program. A typical choice for an average electroplater having sales of $1,000,000 and net after tax income of $35,000 faced with a $400,000 pollution control equipment purchase might look as follows:

Alternative #1 Conventional Bank Financing on

$400,000

at 1% over prime payable over five years

- Assume 16% average interest rate over 5 years.

Alternative #2 Tax-exempt bonds guaranteed by S.B.A.

at 10 1/2% - fixed rate payable over twenty years

on $400,000 + $77,000* = $477,000

Alternative #1		Alternative #2	
Debt Service			
60 months at $9,727.22		240 months at $4,754.19	
Effect on Typical Income Statement			
Sales	$1,000,000	Sales	$1,000,000
Operating Expenses	$ 930,000		$ 930,000
Depreciation	$ 35,000	Depreciation	$ 35,000
Net Income	$ 35,000	Net Income	$ 35,000
Cash Flow Available		Cash Flow Available	
for Debt Service	$ 70,000	for Debt Service	$ 70,000
Debt Service	$ 116,726.64	Debt Service	$ 57,050
Net Cash Flow	($46,726.64)	Net Cash Flow	($12,949.72)

If the small business finds it necessary to finance under Alternative #1, although no banker I know of would lend it the funds, a negative cash flow of $46,726.64 will result. It is obvious that the business cannot survive under Alternative #1. Although the impact of the financing under Alternative #2 is certainly not positive for the company, financial survival is still a

possibility. As all members of the industry begin to take on similar financing burdens prices will be forced up and the company's former profitability should be achieveable. This hypothetical small business would never have had a chance for survival if just Alternative #1 was available. It would never have been able to obtain a loan.

In my experience, the above example is a close approximation of what a great majority of the electroplaters I have spoken to face. I have addressed EPA sponsored conferences on pollution-control requirements for the electroplating industry in New York, Boston, Philadelphia and Dallas. At each of these conferences the only reasonable hope that was held out to these small businesses was the S.B.A. guaranteed financing program. Having had experience in financing businesses of all sizes and knowing what sources are available today, I feel for many businesses this program is their only hope. As one of the more active underwriters of S.B.A. guaranteed pollution-control bonds we, as a firm, have felt a terrific increase in demand for the program over the last year. A great portion of this surge of inquiries is attributable to the marketing effort of underwriters, the efforts of various industry associations in the education of their members and the efforts of the Enviornmental Protection Agency to educate those businesses they are forcing into compliance.

Currently, McDonald & Company has 79 applicants at some stage in the process of application. Of these applicants thirteen, for a total par value of $30,150,000, have at least completed their application requirements and have their application in the hands of the S.B.A. Three of these applicants have received written guarantee commitments from the S.B.A. for a November 15, 1981 closing date. Currently, an applicant for a guarantee commitment can

anticipate a wait of over one year for funding through the program. For this reason we find it very difficult to suggest that a small business continue to put all their hopes in receiving funding via this program.

As an underwriter active in the Guarantee program we make initial contact with most of the program's potential applicants. Our job as underwriters is to pre-screen each applicant for their ability to meet the S.B.A. credit criteria. The Small Business Administration is not acting as the lender of last resort in this program. Rather it is allowing a healthy small business, whose only fault is it cannot access the same debt market larger companies find available to meet environmental regulations in a financially responsible manner. It is vitally important that the Small Business Administration Pollution Control Guarantee Program be kept viable and efficient.

Mr. BEDELL. Next we will hear from David Cordish, representing Energy Resources, Ltd., Baltimore.

TESTIMONY OF DAVID CORDISH, ESQ., ENERGY RESOURCES, LTD., BALTIMORE, MD.

Mr. CORDISH. Mr. Chairman, members of the committee, Energy Resources is a user of the program, I guess the first one you have heard from today. I think if I tell you for 1 or 2 minutes the industry we are in, it may bring home to you, better than any other thing I can do, the effectiveness of the SBA pollution control revenue bond system.

Energy Resources collects waste oil from both filling stations and industry. Waste oil very simply is, if you think about your automobile, you drive it in, and they take out the dirty oil, and that is waste oil. What do they do with it?

In the United States for 30 to 40 years there was a thriving industry in the collection of waste oil. At one time there were over 100 firms across the country, of varying sizes, collecting this waste oil, cleaning it up, and using it for burning purposes, sometimes mixing it with virgin oil and sometimes just burning it as industrial heating fuel.

Over the past 10 years, the number of firms engaged in this business has dwindled from 100 to under a handful. They have dwindled because of probably, very correctly, a tightening of pollution laws which make it impossible to process and clean that waste oil as it used to be done.

Very simply stated, this 100-plus firms cleaned the waste oil, the dirty oil, with a process called acid clay. You simply filtered the dirty oil through clay, and that cleaned it and enabled you to use it again.

The problem from a pollution standpoint was what to do with the highly toxic clay that resulted from this cleaning process. As this process has become environmentally outlawed throughout the country, both by State and by Federal legislation, these businesses have closed up, so that the United States has had a compounding problem with the waste oil: No. 1, what do you do with it now that nobody picks it up to clean it up anymore; and No. 2, we are losing a valuable resource; that is, the ability to use this oil over again.

The Energy Resources firm, which operates near a small town, Chambersburg, Pa., has been in this business, is facing these pollution laws, has tried to meet them in a band-aid kind of way over the years, and simply cannot do it anymore and stay in business.

A slightly different approach than simply getting a machine that would get rid of the acid clay has been adopted by Energy Resources, solely through the mechanism of the SBA. There was no other way we could have done it.

We are building a machine that will not only clean up the oil and change our operations so that the acid clay is not a problem, and there is no pollution problem, but the oil actually will be cleaned up so that it can be recycled again as lubricating oil indefinitely.

Dirty oil does not lose any of its properties as good oil. It is just dirty. If one cleans it sufficiently, you can use it again, and again, not just once more as burning fuel. While it was not bad to collect it and use it at least one more time as burning fuel, now we are taking dirty lubricating oil, reprocessing it back to lubricating oil, and keeping this cycle going indefinitely.

So, the advantages would seem to be obvious. From an energy conservation standpoint you are conserving vast amounts of lubricating oil—from a pollution standpoint it will now be done in an environmentally safe way. From a pollution standpoint you will no longer have the problem of the oil just being dumped.

By the way, 50 percent of all oil changes in automobiles today are done by people at home, done away from garages and so forth. What happens to most of that oil unfortunately is most people dump it down the sewers, it gets into the streams, et cetera.

Society has created a self-defeating mechanisn. There is no place to take the dirty oil; nobody takes it anywhere. Nobody picks it up because the firms that used to be in the business are going out of business.

Energy Resources is typical. There are other firms like us using this SBA program.

The machinery necessary to recycle this oil and to do it in an environmentally sound way is expensive. It is impossible to go to the banks and get the kind of credit necessary. When I say it is impossible, I am not focusing particularly on the interest rate, as Mr. Holloway indicated in his testimony. He seemed to feel if interest rates were to drop, that would solve all the problems. What I am talking about is that it would not solve the problem at all. It would be nice if rates dropped. I think we would all like to see interest rates drop. However, what we are talking about here is a question of credit. It is that SBA guarantee, which enables us, and I think other firms like us, to be able to buy the expensive equipment that it takes in our case to recycle the used oil.

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Mr. MOLINARI. Mr. Cordish, you talked earlier about the filtration-through-clay process. Now you have gotten into a different type of technology.

Mr. CORDISH. Yes, sir.

Mr. MOLINARI. But you have not said how this technology works or what you do with that part of the product that you had difficulty in the earlier process.

I am wondering if you would tell us about that.

Mr. CORDISH. There will be no clay whatsoever in our recycling of the dirty oil now. It is done through a complicated process. It is a very expensive machine. It heats it, evaporates it, does a lot of different things to it. I am not a technical expert.

Mr. MOLINARI. Do you have a byproduct you have to dispose of?

Mr. CORDISH. No, sir. The only byproduct is a little bit of ash, which you can mix in, and we sell to the asphalt companies. It is an asphalt filler. But there is no hazardous waste byproduct in the new process.

Mr. HILER. Will the gentleman yield?

Is this a process similar to those that take place in the cleaning of paints? Does it operate on a cycle?

Mr. CORDISH. I think so, but I am not expert enough. Don't count on anything I say about paints. It is technology that exists in other places in the world, and has for a number of years, but it has not come to the United States I guess for several reasons.

Oil was so cheap. We had it so plentiful. There was no need. In South Africa and West Germany, in Japan, the technology that we will be building exists already.

Mr. MOLINARI. You don't have it in operation now?

Mr. CORDISH. Now, we are just in the process. It is interesting. In some of these countries I have just named it is a criminal offense when you buy a quart of oil at the equivalent of Western Auto not to bring the oil—your dirty oil—back to the store where you bought it.

They recycle in West Germany, for example, 98 percent of the lubricating oil back into lubricating oil. In the United States it is less than 1 percent. It is infinitesimally small.

Mr. BEDELL. About what sort of costs are you talking about for the installation of this?

Mr. CORDISH. We are talking about $5 million. This is a maximum loan that the SBA authority presently allows. That is the kind of equipment you are talking about here.

Mr. MOLINARI. What kind of projected profit will you net with this technology in place?

Mr. CORDISH. We have different projections. It will depend on how efficiently the machine operates. There is no question that the process works; that is, that you can take the dirty oil and clean it up and have lubricating oil you can put back in your car or machine.

The question will be whether it operates in a cost-effective manner every day, 10 hours a day, or whether it will have a certain amount of down time. We won't know until we are in operation.

Mr. MOLINARI. It may not be profitable at all?

Mr. CORDISH. It may not be profitable at all. It might be quite profitable, modestly profitable. All our indications are it should certainly be profitable enough to meet our debt service and expenses.

There is no reason why not. You are picking up oil from filling stations and other people and businesses for 10 cents a gallon, 5 cents a gallon, some places they are happy just to have you come pick it up for nothing, and then you are talking about selling oil that is clean and usable.

So, there is quite a spread. There is no reason why this shouldn't work. As I say, it is working in various places throughout the world. We are betting all of the company's assets. The company has been in business 37 years and never had a year where it didn't make a profit.

Mr. MOLINARI. There is no place in the United States where this technology is being used now?

Mr. CORDISH. No. There are half a dozen places that are using some variation of what I am describing to you. What we are doing we think is combining the best—it is really a three-part machine. There is a beginning treatment step, a major middle step, and a finishing step, as you polish the oil.

We are combining what we think are the best of several of these steps, so there is nobody doing it exactly the way we will do it, but there are people.

In Chicago, for example, one of the railroads—there is a firm out there that has a closed loop with the railroads. This is really the most successful example in the United States. Chicago has tremendous amounts of railroad lubricating oil. The firm out there picks it up from them at a price, cleans it up, and takes it back to them. This gives them both a guaranteed supply and a guaranteed buyer.

It is being done successfully. They have been in business several years doing it, using a machine similar to what we are doing, but not identical.

Mr. MOLINARI. Just one more question. I am fascinated by what you have to say. The one thing I do not understand thus far is how you make the balance that is not recycled disappear into the air?

Mr. CORDISH. Basically, very simply, it is heated to very high temperatures. It is evaporated, certain things settle and are mixed with other things, that give you this ash as a byproduct of it. Things are evaporated.

I would be happy to supply you with some of the literature on it. It isn't all that complicated, but it would take me a little while to explain it. I would be happy to supply it to you.

Mr. MOLINARI. I would appreciate that. Also, if you would supply the names of those other firms, even though the technology is not the same, that use variations of the technology discussed.

Mr. CORDISH. I would be glad to.

Mr. BEDELL. Are you through?

Mr. CORDISH. Just a couple more comments, Mr. Chairman.

One other thing that occurs to me in the arguments that I heard earlier concerning when you do these with IRB's, it is a hypothetical loss to the Treasury. As I understand it, the loss to the Treasury is if the same work were done through a taxable bond, the Treasury would get revenue from it.

It seems to me you then get to the question in this area, this peculiar area of pollution bonds, would the work be done anyway at a taxable nature so the Treasury would get revenue.

My answer to you would certainly be for our firm, and those that I know doing similar things, the answer is they would not be done at all. So, the fact they are done on a tax-free basis is not costing the Treasury anything.

There is no chance on Earth that our project would have proceeded without this particular program.

My final comment is a gratuitous one on the operation of this little office of the SBA. I cannot comment on the overall SBA, but Mr. Fragnito, who was sitting immediately to where my left would be, who runs this, he and his program are a marvel of Government efficiency.

I think I know why—and I would like to just share it with you—the entire program is run by a maximum of three people. In my history of dealing with it, many times it is down to one person, which is Mr. Fragnito. Sometimes he has a Secretary and assistant, and sometimes he doesn't.

Lately it seems to me he has been the only person running this entire, presently $100 million loan guarantee, whatever it will ultimately be. You get quick answers. You are told yes or you are told no, and you are told what the criteria are.

It seems to me that the marvel of it is that it is the only program I know of that makes a profit every year for the Government. There are fees that are very significant, that you pay, in order to get this loan guarantee. It is all set forth, I think, in the previous SBA testimony.

They have made something like $15 million or $20 million in fees for the Government over its 5-year history and have paid out a grand total of maybe $66,000, which I gather they are going to get back.

Well, you have a program that is taking in for the Federal Government $15 million or $20 million in profits, paid nothing out, and has a staff of one or two people. Now, why that is not a cost efficient, effective thing that would appeal to any administration under any philosophy escapes me as a businessman.

Just for what it is worth, my theory as to why it is so cost effective is that what you have is a centralized—it may not be a good word these days, but this program is run by one guy out of Washington, two or three. It is not scattered throughout the country, but everybody throughout the country finds this program and uses it. The telephones work and the mails work.

Mr. BEDELL. Sometimes.

Mr. CORDISH. Well, the phones work pretty well. So it goes. This is as opposed to many of the things I am familiar with that are highly decentralized, which has advantages and disadvantages.

But the facts are that this is one run solely out of Washington. Whether you are in California or Pennsylvania, you just come here, you get an answer, you are told what to do, and you either meet the criteria or you don't. And so it works.

Those would be all my remarks.

Mr. BEDELL. Thank you very much.

Mr. Cooper, we will hear from you next.

TESTIMONY OF MICHAEL B. COOPER, DIRECTOR, EQUIPMENT AND TECHNOLOGY PROGRAMS, NATIONAL SOLID WASTES MANAGEMENT ASSOCIATION, WASHINGTON, D.C.

Mr. COOPER. Thank you.

Mr. Chairman, subcommittee members, my name is Michael Cooper. I handle resource recovery and equipment matters for the National Solid Wastes Management Association.

The solid wastes management industry is very competitive. There are only four large national companies in the industry. By our estimates, the 10,000 small waste service businesses earn about 80 percent of the total waste service revenues for this country.

We are aware of the current Treasury and executive department reviews being conducted concerning IDB's. We have heard significant changes to the whole program maybe in the offing. Unfortunately, the individual programs are not identified by this broad-brush treatment.

I would like to describe to you how we feel the pollution control IDB program is being used to aid by improving solid waste management practices across the Nation, which furthers the intent of Congress as expressed in RCRA.

Section 103 of the Internal Revenue Code provides that IDB's to be used for pollution control have a tax-exempt status. This Federal tax policy supports the basic thrust of RCRA, which is to reduce pollution from solid wastes and to conserve materials and energy.

This policy encourages private investment in public purpose projects, which include waste disposal facilities. These facilities include solid waste transfer stations, recycling facilities, baling plants, waste-to-energy incinerators and related projects.

Project financings for many of these facilities have depended on the use of tax-exempt revenue bonds as a means of borrowing funds at reduced interests costs. Reducing these interest costs is necessary due to several market deterrents which act against investment in the solid waste disposal industry. Were it not for the availability of tax exempt financing, many of these facilities would not be built. I will amplify on that in a moment.

Tax-exempt pollution control IDB's are used by both small and large businesses. On the small business side, there are small business manufacturers and distributors who make equipment for the small business entrepreneurs to start businesses or to expand their businesses. Most of our small business members have used the tax-free IDB vehicle to finance their projects in this manner.

I would like at this time to describe three representative projects. I would also like to enter into the record a statement of one of the owners, Mr. Alvin White of Atlantic Disposal Service, Mt. Laurel, N.J.

Mr. White sends his regrets he could not be here today.

[Mr. Cooper's prepared statement and attachment follow:]

Prepared Statement of Michael B. Cooper, Director, Equipment and Technical Programs, National Solid Wastes Management Association

The NATIONAL SOLID WASTES MANAGEMENT ASSOCIATION is the national organization representing the private sector of the waste service industry. A great majority of our members are the many small businesses involved in collection of residential, commercial, and non-hazardous industrial refuse, as well as its disposal. Pollution control industrial development bonds (IDB's) and the ability to pool small issues have been a valuable financial tool for small private waste service firms to undertake new capital investment. NSWMA affirms its continuing support for the use of industrial development bonds in financing pollution control facilities.

The solid waste management industry is very competitive. There are only four large national corporations in the industry. By our estimates, the approximately ten thousand small waste service businesses earn about 80% of the total waste service revenues in this country.

We are aware of the current Treasury and Executive Department reviews being conducted concerning IDB's. We have heard that significant changes to the whole program may be in the offing. Unfortunately, the individual programs are not identified by this broad brush treatment. My purpose today is to describe how the pollution control IDB program is being used to aid in improving solid waste management practices across the nation thus furthering the intent of Congress as expressed in the Resource Conservation and Recovery Act.

Section 103 of the Internal Revenue Code provides that IDB's to be used for pollution control have a tax-exempt status. This federal tax policy supports the basic thrust of RCRA, to reduce pollution from solid wastes and conserve materials and energy, and encourages private investment in public purpose projects which include waste disposal facilities. These facilities include solid waste transfer stations, recycling facilities, baling plants and facilities, waste-to-energy incinerators and related projects. Project financings for many of these facilities have depended on the use of tax-exempt revenue bonds as a means of borrowing funds at reduced interest costs. Reducing interest costs, which some contend represents federal participation, is necessary due to several market deterrents which act against investment in solid waste disposal facilities. In fact, were it not for the availability of tax-exempt financing, many of the facilities would not be built. I will amplify on this in a moment.

Tax-exempt pollution control IDB's are used by NSWMA members who are both small and large businesses. On the small business side, there are small business manufacturers and distributors fabricating equipment and distributing it for small business entrepreneurs to start solid waste disposal and recycling businesses or to expand their existing businesses. Most of our small business members who have used the tax free IDB vehicle were only able to finance their project in this manner. I have attached a description of three such projects.

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When competing for investment dollars, the solid waste industry is disadvantaged because:

> For resource recovery systems, the revenues are fixed by the current market for the product, be it material or energy, and by the cost of the disposal alternative--landfilling. Fluctuations in the prices for materials or in the prevailing price of displaced fuels affect the ultimate economic vitality of the projects. Federal subsidies currently exist for many fuels and for many virgin materials which compete with the products of ~~resource~~ recovery projects. Further, the existence of "open dump" and poorly managed landfills act to lower the dumping fees which can and should be charged by projects, again affecting the economic vitality.
>
> For transfer stations, the revenues are fixed by the disposal fees and by the savings in transportation costs. Disposal fees again are in competition with "open dumps".[12] (Transfer stations are processing areas to agglomerate garbage truck loads into an economic size for further transportation to a distant sanitary landfill. Transfer stations have become an important option as landfill sites begin to move farther away from where the waste is generated).

When these factors are added up in today's market, the economic feasibility test will not be passed unless debt service is minimized by: the use of tax-exempt bonds for the debt portion of the long-term financing along with small business loan guarantees; and by attracting private equity to reduce the amount of debt which must be sold in the bond marketplace. Please note here that the accelerated depreciation provisions of the 1981 Economic Recovery Act are now equally applicable to most private investment projects, whether these projects are pollution control or general business investment. Likewise investment tax credits are also available. Thus investment in pollution control facilities is encouraged by tax-exempt IDB's (worth 2-3 percent in reduced interest) and energy tax credits where applicable (worth up to 1 percent in reduced interest).

It is certainly a truism that small firms have more limited access to capital than large firms, and this is as true in the solid waste industry as in others. The access of our small businesses to IDB's and the bond pooling program has enabled them to continue to compete effectively and to provide economical services to their customers, many of whom are themselves small businesses. Studies by Columbia University under a grant from the National Science Foundation have shown that the cost of contract refuse service provided by private firms averages 29% less than the same service provided by a public agency. The continued competitiveness of small private waste firms is good public policy.

The ability to use and pool small bond issues into offerings of attractive size to investors, along with the SBA pollution control bond guarantee program, has been vigorously promoted by SBA and by the U.S. Environmental Protection Agency. According to EPA's recent publication Federal Financial Assistance for Pollution Prevention and Control only two states lack state revenue bond financing programs for pollution control. In only five states, cities and/or counties do not have similar programs.

Before closing, and I will not dwell long on it, the pollution control IDB exemptions also permits funding of large resource recovery and waste-to-energy facilities. The same market forces operate on these facilities. We are aware of feasibility studies on-going in at least sixty cities across the several states. Vendors have been selected in half a dozen of these cities and arrangements for financing are underway. Through the use of tax-exempt financing, accelerated depreciation and investment tax credits, the cost of capital and the size of the project's indebtedness can be reduced. This in turn reduces the disposal fee and avoids risks that can prohibit development of these projects. Modification or elimination of the pollution control financing method as it exist today will have the effect of seriously delaying or stopping these projects.

Lastly I wish to point to the ineligibility of hazardous waste facilities to use industrial development bonds. Currently, IRS has ruled

that these facilities are ineligible because hazardous waste does not fit the solid waste definition. We note that the IRS Code uses an outmoded definition of solid waste which does not include hazardous waste. Congress changed the definition of solid waste to include hazardous waste way back in 1976, however, the IRS refuses to accept the new definition. Convincing IRS to change its definition would help our industry provide small manufacturing firms, which generate hazardous waste but do not have the capacity to dispose of their own waste, with much needed expansion in off-site treatment and disposal capacity.

In summary, NSWMA is concerned about the attack on the pollution control industrial development bond concept. Many of our members, such as those firms building resource recovery plants and those who own and operate waste disposal facilities have been able to use these bonds to help in financing sorely needed facilities for solid waste management.

We believe this program, designed to encourage investment in projects for the public good, must be preserved. We appreciate this opportunity to advise you of the total impact on this program.

DESCRIPTION OF PROJECTS

Pollution Control Bonds Help A Small Business Hauler

In 1979, a small business refuse hauler in the Los Angeles area became aware that a major landfill was being constructed about 50 miles away from his area of operations. The hauler identified an essentially abandoned transfer station and commenced proceedings to purchase the station, rebuild it, and purchase the required transfer trucks and trailers. His efforts were unsuccessful until contact was made with the California Pollution Control Financing Authority. Under their guidance, he was able to obtain a $7.5 million pollution control loan with tax free IDB's. This site is now a successful operation. It has reduced truck traffic and associated pollution from the haulers' collection area to the landfill by 75%. Further, the facility was designed to recycle selective products (between 5 and 10% of the incoming waste stream is now recycled) and further designed to process the solid wastes to make a refuse derived fuel (RDF). RDF processing equipment will be added to the transfer station when an appropriate waste-to-energy facility is built.

The facility employs 20 people within an annual salary of about half a million dollars. No employees were previously working at the facility. No existing refuse truck drivers or other employees were released when the facility went into operation.

The owner emphatically stated that this project could not have been built without the use of pollution control IDB's.

Pollution Control Bonds Help A Small Business Recycler

In 1980, a small business recycler in Houston, Texas sought to start a recycling operation, primarily recycling paper fibers and related materials. Funding for this effort was provided through a $1.4 million pollution control IDB issue. This facility is currently in shakedown and expected to be in full operation within the next two months. It is anticipated that the facility will employ between 7-10 people when in full operation.

The owner emphatically stated that this project could not have been built without the use of pollution control IDB's.

Pollution Control Bonds Help Mr. Alvin H. White
of ATLANTIC DISPOSAL SERVICE, INC., Mt. Laurel, NJ

In 1979, Mr. Alvin H. White and his partner identified the need for a transfer station near Cherry Hill, New Jersey. The State had been taking action to close polluting landfills but had not at that time made provisions to redirect the waste flow. The landfill was only 17 miles away from Mr. White's general area of operations, but routinely was a one and a half hour trip with each truck. Using tax free pollution control bonds, Mr. White built the station costing about $790,000. Its use increased productivity by 30%, provided jobs for 15 people (annual payroll about $225,000) and is used by both the public municipalities and other private sector haulers.

Mr. White, in his attached statement, wrote, "If this type of financing would not have been available, it is very doubtful that ATLANTIC RECOVERY & TRANSFER SYSTEM would have been built due to excessive interest rates."

PREPARED STATEMENT OF ALVIN H. WHITE, CO-OWNER, ATLANTIC DISPOSAL SERVICE, AND ATLANTIC RECOVERY & TRANSFER SYSTEM, INC., MT. LAUREL, N.J.

Mr. Chairman and members of the Committee. My name is Alvin H. White and I am co-owner of both Atlantic Disposal Service, Inc. and Atlantic Recovery & Transfer System, Inc. located in Mount Laurel, New Jersey.

Atlantic Disposal Service has offered essential waste reduction services for the area's residents and business concerns for over 18 years and our new venture, Atlantic Recovery & Transfer System, has become a valuable asset to the area's municipalities solid waste planning efforts.

For a short explanation - A refuse transfer system accepts waste material from short-range collection trucks, compacts that material and finally transports it in large capacity trailers to a final disposal site. Direct savings are realized thru the elimination of costly repairs to vehicles caused by rough sanitary landfill conditions, and fuel and labor costs are reduced by eliminating the number of trucks making the long haul to the disposal site. The use of the transfer station is not only an innovative and economical way to handle solid waste, but improves the quality of the environment thru the reduction of vehicles and their time on the road.

Atlantic Recovery & Transfer System's financing was obtained thru and Economic Development Authority (EDA) loan guarantee, and falls under the category of 'tax free pollution control' bonds. Atlantic Recovery & Transfer System was constructed with the aid of private money. We obtained a bank which would lend us the

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money under the EDA loan guarantee program, the bank is exempt from paying federal and state taxes on the interest earned from this revenue, and the government does not actually put up any monies for the construction of this project. This type of financing shows how the system can effectively work, and to date, I know of no other projects like this being funded with government money. If this type of financing would not have been available, it is very doubtful Atlantic Recovery & Transfer System would have been built due to excessive interest rates.

As an owner of a small business concern, one which performs an extremely valuable service for the public, I would like to voice my distress over the fact that the government is considering dropping this program. I've done some research regarding small businesses and have gathered the following statistics:

> There are more than 12 million small businesses operating in the United States, producing 40 percent of the Gross National Product, providing 56 percent of all jobs in the American labor force, providing 86.7 percent of the nation's new jobs in the private sector, and in my home state of New Jersey, providing jobs for more than 50 percent of the state's workforce. Dollar for dollar, small companies out-produce large firms in job creation and in technological innovation.
>
> Excerpts from prepared Text of Speech Gov. Brendan Byrne gave before Governor's conference on small business,6/13/81.

These, I believe, are pretty hefty facts, and not to be lightly pushed aside. In an economy where monopoly pricing and marketing control by larger firms fuels inflation the small business plays a valuable role in stablizing the market.

Unfortunately, over the past few years we have seen a number of small businesses go under. On-going inflation and staggering interest rates hit the small business first because they are not afforded those benefits of a large corporation which can secure financing thru public offering or the major banking institutions. The loss of this type of financing ability will severely cut into small business and the economy alike.

The solid waste management industry is made up of small businesses. These private companies collect more than 50% of the residential and more than 90% of the commercial/industrial refuse generated in this country.

The industry is very aware of the important role it plays in the overall protection of the public's health and the quality of the environment, and many currently employ a variety of state-of-the-art waste disposal techniques.

Solid waste management has become a crucial issue in many states, and New Jersey is a good example. Landfill availability is quickly running out and those sites that are open are miles beyond the collection point. Since the private sector plays such a valuable role, it therefore becomes necessary for the private sector to invest into these new methods of handling solid waste, such as we did with the construction of our transfer station. However, since most of the private sector in the waste industry consist of small businesses, financing these projects becomes a major hurtle. Many companies which are now contemplating

such projects will remain in that very stage until interest rates come down or unless alternative financing is available. The question to be considered is - can we put off these type projects?

Atlantic Recovery & Transfer System has indeed helped to improve the environment, is providing jobs, and returning approximately 80% of the annual EDA loan repayment to various levels of government thru federal income tax, FICA, NJ income tax, unemployment taxes and real estate taxes. In addition, this facility has enabled other area small solid waste haulers, as well as municipalities to improve routing operations cutting costs in areas of fuel, labor, vehicle maintenance and the life span of their vehicles.

Alternative financing is extremely necessary for small businesses throughout the United States, and for the waste management industry it becomes crucial because of the vital role it plays.

Mr. COOPER. In 1979, a small business refuse hauler in the Los Angeles area became aware that a major landfill was being constructed about 50 miles away from his area of operations. The hauler identified an essentially abandoned transfer station and commenced proceedings to purchase the station, rebuild it, and purchase the required transfer trucks and trailers. His efforts were unsuccessful until contact was made with the California Pollution Control Financing Authority. Under their guidance, he was able to obtain a $7.5 million pollution control loan with tax-free IDB's. This site is now a successful operation. It has reduced truck traffic and associated pollution from the haulers' collection area to the landfill by 75 percent. Further, the facility was designed to recycle selected products—between 5 and 10 percent of the incoming waste stream is now recycled—and further designed to process the solid wastes to make a refuse derived fuel [RDF]. RDF processing equipment will be added to the transfer station when an appropriate waste-to-energy facility is built.

He anticipates sometime in the future an RDF plant will be constructed in the area. He intends to provide fuel for that plant.

The facility employs 20 employees with an annual salary of about half a million dollars. No employees were previously working at that facility, and he let none of his employees go when it went into operation.

That owner emphatically stated his project would not have been built without the use of this funding mechanism.

In the second case, in 1980 a small business recycler in Houston, Tex., sought to start a recycling operation, primarily recycling paper fibers and related materials. Funding for this effort was provided through a $1.4 million pollution control IDB issue. This facility is currently in shakedown and expected to be in full operation within the next 2 months. It is anticipated that the facility will employ between 7 to 10 people when in full operation.

The owner emphatically stated that this project could not have been built without the use of pollution control IDB's.

In the third case, Mr. Alvin H. White and his partner identified, in 1979, the need for a transfer station near Cherry Hill, N.J. The State had been taking action to close polluting landfills but had not at that time made provisions to redirect the waste flow.

The landfill was only 17 miles away from Mr. White's general area of operations but routinely was a 1½-hour trip with each truck. Using tax-free pollution control bonds, Mr. White built the station, costing about $790,000. Its use increased productivity by 30 percent, provided jobs for 15 people—annual payroll about $225,000—and is used by both the public municipalities and other private sector haulers.

Mr. White, in his attached statement, wrote, "If this type of financing would not have been available, it is very doubtful that the Atlantic Recovery and Transfer System would have been built due to excessive interest rates."

When competing for investment dollars, the solid waste industry is disadvantaged because:

One, for resource recovery systems, the revenues are fixed by the current market for the product, be it material or energy, and by the cost of the disposal alternative—landfilling. Fluctuations in the prices for materials or in the prevailing price of displaced fuels affect the ultimate economic vitality of the projects. Federal subsidies currently exist for many fuels and for many virgin materials which compete with the products of resource recovery projects. Further, the existence of open dump and poorly managed landfills act to lower the dumping fees which can and should be charged by projects, again affecting the economic vitality.

Two, for transfer stations, the revenues are fixed by the disposal fees and by the savings in transportation costs. Disposal fees again are in competition with open dumps.

In today's market, the economic feasibility test is minimized by the use of tax-exempt bonds for the debt portion of long-term financing, by small business loan guarantees, and by attracting private equity to reduce the amount of debt which must be sold in the bond marketplace.

Please note here that the accelerated depreciation provisions of the 1981 Economic Recovery Act are now equally applicable to most of private investments, as well as projects for pollution control. Likewise, investment tax credits are also available. Thus, investment in pollution control facilities is encouraged by tax-exempt IDB's—worth 2 to 3 percent in reduced interest—and energy tax credits where applicable—worth up to 1 percent in reduced interest.

Small businesses have more limited access to capital than large firms. We would agree with that statement.

There is one other, two other points that I would like to make

before closing concerning the pollution control IDB issues. Pollution control IDB's permit funding of large resource recovery and waste-to-energy facilities. The same market forces operate on these facilities. We are aware of feasibility studies ongoing in at least 60 cities across the several States. Vendors have been selected in half a dozen of these cities, and arrangements are currently under way for financing. Through the use of tax-exempt financing, accelerated depreciation, investment tax credits, the cost of capital and the size of the project's indebtedness can be reduced. This in turn reduces disposal fees and avoids the risks, and that can prohibit development of these projects. Modification or elimination of the pollution control financing method as it exists today will have the effect of seriously delaying or stopping these projects.

I would like to point out too the ineligibility of hazardous waste facilities to use industrial development bonds. Currently IRS has stated that these facilities are ineligible, because hazardous waste does not fit the solid waste definition. Congress changed the definition of solid waste to include hazardous waste in 1976. However, IRS refuses to accept the new definition. Convincing IRS to change this definition would help our industry provide small manufacturing firms, which were described earlier today which generate hazardous waste but do not have the capacity to dispose of their own waste, to generate the much needed expansion in offsite treatment for these facilities.

In summary, NSWMA is concerned about the attack on the pollution control industrial development bond concept. Many of our members, such as those firms who have building resource recovery plants, and those who own and operate waste disposal facilities have been able to use these bonds to help in financing facilities.

We believe this program designed to encourage investment in projects for the public good must be preserved.[1]

Mr. BEDELL. We will now have an opportunity to question all three of the witness.

Mr. Hiler.

Mr. HILER. Mr. Gibbons, you were mentioning that some firms with net worths under $400,000 are required to put in a capital investment of, let's say, one-half million to a million dollars for essentially a nonproductive use, a social use that in all likelihood would not return a profit in many of the cases of pollution control. This is different than the example you gave, which is definitely a revenue generating form of pollution control equipment.

Without getting into whether the regulations that would require this expenditure are good or not, do you think, in general, that small businesses that have low net worth would have to put substantial amounts of money in the nonproductive assets?

Is this just a stopgap before recognizing it will not be possible for small firms to stay in business anyway?

Mr. GIBBONS. If the program itself being a stopgap is what you are referring to, I would say that yes, it is a stopgap, and it is a very important one, because indeed I don't know of any electroplater that could finance one-half million dollars worth of nonproductive assets with a net worth of $400,000.

That is a very realistic picture. I don't think they can exist.

Mr. HILER. If I am not mistaken, the new environmental regula-

[1] See Appendix C for additional statement on behalf of the National Solid Wastes Management Association.

tions that relate to platers could mean that about 55 percent of the industry will go out of business?

Mr. GIBBONS. I am not an expert on that industry by any means, but I have been to enough EPA-sponsored conferences to hear that number quoted many times.

I think you have seen the number of foundries that are no longer in business.

Mr. HILER. I am in the foundry business.

Mr. GIBBONS. In fact, at this very moment, we are in the process of marketing a bond issue for a company out of Massillon, Ohio, in the foundry business. They have a net worth in the area of a million dollars, and are required, in this particular case, to clean up their emissions from their shell molding operations. They will have to spend $690,000 to do that. That business is not real profitable right now.

They would be out of business literally in 6 months without this program.

Mr. HILER. Take the example of the platers. Of 9,000 existing platers, 4,500 to go out of business because of the regulation.

Let's say that the average expenditure was one-half million dollars. That would mean that the entire pollution control guarantee program would be necessary to give guaranteed loans to just the plating industry, and probably the people that face going out of business might not have the profitability to service the debt anyway?

Mr. GIBBONS. There is probably a more rigorous analysis done of each of the companies going into this program than a lot of the other programs that I have had any knowledge of.

There is an SBA credit criteria.

Both the company itself, the underwriter, and usually there is an underwriter that offers these bonds publicly, and the qualified sponsor which typically is the bank of account of each company must look to the financial viability of the project.

There are so many different levels of analyses even before it gets to Vince Fragnito and the people on the staff of the Office of Special Guarantees. Then they take another look at it, and if they feel that this is a viable project, and this company will make it, and that they do indeed need this financing to help them overcome some governmentally imposed necessity for funds, then the loan is granted.

The guarantee is granted and without the guarantee, the loan is impossible.

Mr. HILER. Yours was going to be $5 million?

Mr. CORDISH. Yes.

Mr. HILER. The total program has $250 million, potentially, which means that there are 450 lucky firms around the country that could meet the criteria, and yet there are more than 450 profitable firms that face extinction by not being able to meet some type of pollution control requirement or EPA requirement.

I guess my question becomes whether it is $100 million or $250 million or $2 billion, isn't the amount insignificant compared to what the cost is being faced by small business today to meet many of our environmental and pollution regulations?

That is why I say it is a stopgap measure, a measure that is needed, without question. But could we ever fund it to the levels where it would be adequate?

Mr. CORDISH. The equation you have to crank in is how many businesses are willing to take the risk of betting everything that they have and come into this SBA financing door?

Just because if you made this program $3 trillion, so every electroplater could come in, everybody is not going to come in because you are betting everything you have got on, you know, you have built up over the years, and it just does not work that way. Most people are not willing to do that.

Mr. HILER. What you are betting the other way is going out of business. You take a foundry that has to put out $600,000, their bet is, do we continue as a foundry, or do we close the doors?

Eighty percent of the foundry industry has fewer than 100 employees, and 60 percent of the businesses are family owned.

Mr. CORDISH. I serve on the board of a foundry.

There is an alternative. I can sell off your assets, sell the business out to some big company. You know, there is something in between going in and betting everything you have got on this air pollution bond that is guaranteed. And going out of business. There is also slow death, you band-aid it and band-aid it and hope you can beat the regulation.

When you go into that SBA program, you are signing on the line everything you have. You don't need a debt service payment if you keep muddling along, there are a lot of these regulations which are tough, but you can finesse them for years and sell things off.

I don't think you would, say, if you made the program $1 trillion, you won't see $1 trillion worth of people coming in.

I am on a board that is wrestling with the same things you are wrestling with, what to do.

They have not used this program.

Mr. HILER. My concern is that when we talk, and I reiterate that this is a needed program, the Government has decided that there is a social good there. We are imposing a tremendous burden on small businesses. Of course, the large businesses can go to the bond market, but it is a tremendous burden on the small businesses in America to meet the cost of the regulations, and I am not sure that any amount of money that we put up from the Federal Government level would ever solve some of the basic inequities that exist, vis-a-vis the ability to cope with the cost of regulation.

What we are doing is a worthwhile goal for the country. We should be doing it.

Mr. CORDISH. I agree.

Mr. HILER. No further questions.

Mr. BEDELL. Mr. Molinari.

Mr. MOLINARI. In your own experience as an investment banker, can you give us an idea as to what the default ratio may have been on the loans that you have placed?

Mr. GIBBONS. At this time in this program, zero. There have been no defaults.

Mr. MOLINARI. No defaults at all?

Mr. GIBBONS. And we very zealously protect that record.

We are very strict in our analysis before we will even attempt to take them into the program, because we want to be looked at with favor in this program.

Mr. MOLINARI. When you say defaults, are you talking about a loss of money?

Mr. GIBBONS. Missed payment. I take that back, we did have a company that missed one or two payments which in this program can be made up out of an escrow fund, but before there was any event of default, they made up all the payments.

There have been no defaults.

Mr. MOLINARI. Do you have any recommendations as to how small businesses can get more involved in being able to qualify for tax-exempt bonds?

Mr. GIBBONS. You face a very big problem. The tax-exempt bond market, that is the market that is publicly traded which is right now the only market available to anybody.

Banks just are not buying tax-exempt bonds right now.

In order to allow the small businesses of the country to get into that market, some outside form of guarantee has to be attached, either a letter of credit, or a guarantee. In this particular case, with pollution control equipment, the lack of collateral value and of its contribution to bottom line, the letter of credit just is not available.

The only available means of obtaining credit for a small business, and I am speaking of the ability to go into the tax-exempt bond market, which really is the only market that makes sense right now for the small business, is the attachment of this Government guarantee.

Without the Government guarantee, they don't have a chance of getting into the public bond market.

It seems to me that there is some logic to that, since they are governmentally imposed regulations, and governmentally imposed expenditures.

If there is a subsidy involved by the use of tax-exempt bonds, the use of those bonds in this situation more so than any other situation, it is offset by the imposition of government regulations.

Mr. MOLINARI. Thank you. Mr. Cordish, referring to your statement that at one time there were 100 businesses in the same type of business that you are in, and now about a handful. I cannot help but wonder why it is that more of the entrepreneurs have not gone into this other technology which has been available for so many years?

Mr. CORDISH. Well, I am only speculating as to why not, I think there are two reasons. Number one, the technology that is available is mainly overseas, and the average businessman, you know, you mention Japan or South Africa, you might as well be talking about the Moon.

The average small businessman does not read that kind of stuff, and is not familiar with it.

Mr. MOLINARI. How about the big businessman?

Mr. CORDISH. This was never a big business operation. We compare it to the milk delivery man who goes door to door.

The big oil companies won't touch it, and we have been to all of them. They will be happy to buy our recycled oil back, and America is having a terrible time getting lubricating oil. Going door to door to filling stations, setting up routes, it is a pain in the neck kind of business and big business. They can't really program it.

I think the other reason is that the cost, as I have indicated, is high. A number of the small businessmen just can't grasp the thought of a $1, $2, $3, $4 million piece of machinery, and you know, it is a staggering number to me.

They look at their alternative, clay is no good, and even if they know about this type of thing, the idea of it, of going into something that big——

Mr. MOLINARI. If your technology proves successful, not only from a technological standpoint but from a profit standpoint, wouldn't this attract others to enter into this type of business?

Mr. CORDISH. We hope so, and I think it is an industry that really must be done in the United States.

I don't know if the committee understands how lubricating oil is produced; but when you get a barrel of crude oil, and it is distilled, 99 percent of it is your gasoline distillate, and you might get 1 percent of a barrel as a lubricating distillate, and that generally only occurs, it is only profitable to have that 1 percent in what is called sweet crude oil, to use an expression.

Quaker State in western Pennsylvania, the reason Quaker State is in western Pennsylvania, they had this very sweet crude oil, and we have had it in the continental United States. Now, as you all know, most of our oil comes from Alaska and places like that. It is a dirty crude, and it has made it very, very difficult to get lubricating oil, and there is a scarcity of lubricating oil over and above the kind of abundance we temporarily have, so it is an industry that needs to be developed in this country.

Mr. MOLINARI. Mr. Cooper, I would like to take the time to get into some of the questions that you raised.

You mentioned that there are only four large national corporations in the solid waste management industry?

Mr. COOPER. Yes, sir.

Mr. MOLINARI. Is Union Carbide one of those?

Mr. COOPER. No, sir.

Mr. MOLINARI. Monsanto?

Mr. COOPER. Black Clawson.

I am talking about the industry that collects the refuse at your doorstep. The four national corporations are: Waste Management, Inc.; Browning-Ferris, Inc.; SCA Services, Inc.; and Superior Sanitation.

Mr. MOLINARI. The earlier part of your testimony also relates to disposal.

Mr. COOPER. Yes, sir.

Mr. MOLINARI. You touched on resource recovery.

Mr. COOPER. Those are companies also involved with the disposal or landfilling of refuse, sir.

Mr. MOLINARI. If you were involved in the Small Business Administration, and you were asked to consider guaranteeing loans to companies in this Nation who want to go into resource recovery business, would you have any reluctance? What caveats would you have in mind, based on your own experience?

Mr. COOPER. In discussing companies going into the resource recovery business (and the National Association of Recycling Industries up in New York could indicate to you that recycling businesses themselves are primarily small business, and they have been that way for years), we would look at the business from the standpoint of: What is the product they are trying to recycle? Is there a market for the product? Do the companies have, more or less, an assured buyer for that product?

Mr. MOLINARI. I think you pointed out one thing that is very, very important, which is that landfilling in many areas is disappearing. And fills are reaching their capacity, and everybody is looking to resource recovery. Yet from what we read and what I have heard, almost every attempt that we have had in this country—now we are talking about large companies—almost every one of them seems to have failed.

Black Clawson put up a plant in Hempstead, and to my knowledge that plant is still down today, down for well over a year, and Monsanto was in the business, and they got out. Union Carbide was in the business. They got out also, so we have had a whole record of failures in this particular field, and yet we are told in Europe, we have had systems that have been operating for 30 years successfully.

What is the matter with this country and our industry that we can't adopt the technology that has been known for so long, and particularly in a field that is becoming so critical throughout sections of this country?

Mr. COOPER. The 60-some projects that I mentioned in the testimony are mostly using technologies that we are reimporting back from Europe.

We had incineration systems that conserve energy at the turn of the century. That technology was imported over to Europe, and we are bringing it back again in the form of waste-to-energy facilities in many, many major cities.

Mr. MOLINARI. Are they members of this resource recovery association?

Mr. COOPER. Yes, sir, we have the major leaders of that industry in the association.

Mr. MOLINARI. I will try to be brief, because I know the chairman has questions.

Could you point out to this committee from your own record what you consider the more successful technologies, the names of the companies that have operating plants in this country?

Mr. COOPER. UOP, Inc., has operating plants in this country; Wheelabrater-Frye has a plant operating in Saugus, Mass. Waste Management Inc. is a licensee for Volund USA which has 90-some plants throughout the world; Browning-Ferris Industries is a licensee for another European technology, O'Connor EnviroTech Corp., from California is currently installing the Galletin, Tenn., plant.

Mr. MOLINARI. That is a fairly representative group, sir. What do you think the future is for the industry?

Mr. COOPER. If the current financial market stays the same, and the pollution control bond mechanism stays the same which means that the projects are able to use the accelerated depreciation, IDB's and tax credits then even with the high interest rates we think we will be able to push these projects forward. If that mechanism is modified, you will see a lot of plants come to at least a standstill for a period of time.

I think that the technology, as far as waste-to-energy facilities are concerned, is proven. It is proven over in Europe. We are building plants here using this same technology. Pinellas County is an example; Harrisburg, Pa., is an example; and Nashville, Tenn.,

is an example. These are plants that are able to produce energy for sale, and they will be successful. They will continue to be successful. As we go more and more into that field, you will see many more successes in that line.

Mr. MOLINARI. I hope so. Thank you very much. No further questions, Mr. Chairman.

Mr. BEDELL. Thank you, Mr. Molinari. You brought up something very important at the end of your questioning. Certainly there is good reason to suspect that IDB's and the tax credits and so on will not necessarily continue to be made available.

This is an energy subcommittee, as well as environmental safety issues.

If I understand your testimony correctly, you are saying if these are cut off, we will not proceed forward as Europe, for example, has in efforts to help solve our energy problems, as well as our environmental problems?

Mr. COOPER. Yes, sir.

Mr. BEDELL. That is a pretty important issue as we look at our total society.

I am grateful to you for bringing that out so clearly.

Mr. Cordish, you indicated that interest rates were one issue but not necessarily the whole issue, and part of the need for the small business guarantee is simply so people can get the money that they couldn't otherwise even obtain.

Do the other two witnesses agree with that? Is that accurate in your opinion?

Mr. GIBBONS. I definitely think so. It is very difficult to obtain loans for any type of pollution control equipment whatsoever.

Mr. BEDELL. Do you agree with him further, for us to look at the tax loss is maybe not completely fair. Some places would simply go out of business, and otherwise it is not a tax loss to not issue the revenue bonds, but it is a tax loss to have them not be in business?

Mr. CORDISH. Absolutely accurate. Actually what they ought to be looking at, they ought to be looking at the tax loss to the Treasury, if they eliminate this program, most of the businesses would go out of business.

Mr. BEDELL. I also appreciate very much your statement in regard to the work over there of the Department headed by Mr. Fragnito. I would hope my challenging of the SBA does not in any way imply that I felt that particular entity was not doing its job.

Mr. Fragnito's got a job doing something that doesn't cost any money, and is beneficial to our society. Does it really make sense to cut them back on that opportunity?

Before we close, we should recognize the fact that, at least Mr. Gibbons and Mr. Cordish spent a considerable amount of their own money to be here to testify before us, and it shows the concern that some people in our society have for what happens in our whole society.

We want to thank you very much for being here, for your testimony, and the committee will be adjourned.

[Whereupon, at 12 noon, the subcommittee adjourned, to reconvene subject to call of the Chair.]

APPENDICES

APPENDIX A.—REPORTS PREPARED BY THE CONGRESSIONAL RESEARCH SERVICE, LIBRARY OF CONGRESS

Congressional Research Service
The Library of Congress

Washington, D.C. 20540

October 29, 1981

TO : Honorable Berkley Bedell
Chairman, Subcommittee on Energy, Environment and Safety
Attn: Marc Rosenberg

FROM : American Law Division

SUBJECT : Federal Financial Assistance Available to Small Businesses Seeking to Comply With Pollution Control Laws

In response to your request for information on the matter above, enclosed is a report prepared by Robert Meltz of the American Law Division, CRS, entitled "Forms of Federal Financial Assistance Available to Small Businesses for Compliance with Pollution Control Laws." A companion report prepared by Howard Zaritsky of the American Law Division covers tax incentives facilitating pollution control investment by small businesses, and was delivered to your office earlier.

If we may be of further assistance, please do not hesitate to call.

Robert Meltz
Legislative Attorney

Exhibit 1.—Federal Financial Assistance Available to Small Businesses.

Congressional Research Service
The Library of Congress

Washington, D.C. 20540

FORMS OF FEDERAL FINANCIAL ASSISTANCE AVAILABLE TO SMALL BUSINESSES FOR COMPLIANCE WITH POLLUTION CONTROL LAWS

Robert Meltz
Legislative Attorney
American Law Division
October 29, 1981

EXHIBIT 1

FORMS OF FEDERAL FINANCIAL ASSISTANCE AVAILABLE TO SMALL BUSINESS FOR COMPLIANCE WITH POLLUTION CONTROL LAWS

The following list presents the more significant avenues by which the Federal Government provides financial assistance to small businesses seeking to comply with pollution control requirements imposed by Federal or State law. Federal financial assistance takes the form of loans, loan guarantees, surety indemnification, and in rare cases, outright grants. Also noted are authorities for Federal support of research and development projects involving innovative pollution control technologies.

Not included here are the various authorities under which the Federal Government channels financial support exclusively to public entities or nonprofit organizations. Exception is made where the public recipient acts largely as an intermediary in passing Federal funds or benefits obtained thereby to specific small businesses.

Because of the special complexities presented, assistance for farms is also omitted.

Tax incentives for pollution control investment are covered in a separate American Law Division report entitled "Federal Income Tax Incentives for Financing the Purchase and Replacement of Small Business Pollution Control", prepared by Howard Zaritsky.

Small Business Loans

Under the Small Business Act, 1/ the Small Business Administration (SBA) is charged with furthering the interests of small business concerns in order to preserve free competitive enterprise. Until quite recently, two provisions

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1/ 15 U.S.C. sec. 631 et seq.

in the Act authorized SBA to grant loans to small businesses for adding to or altering their facilities or method of operation in order to comply with environmental requirements imposed by law. First, section 7(b)(5) [2/] empowered SBA to make loans --

> to assist any small business concern in effecting additions to or alterations in its plant, facilities, or methods of operation to meet requirements ... pursuant to any Federal law [or] any State law enacted in conformity therewith, ... if the Administration determines that such firm is likely to suffer substantial economic injury without assistance under this paragraph ....

A similarly worded provision, section 7(g), [3/] specifically authorized SBA loans to small businesses to meet water pollution control expenses imposed under the Clean Water Act.

In SBA regulations, loans under sections 7(b)(5) and 7(g) were known as "non-physical disaster loans," and were available only when assets of the applicant (usable without undue hardship) and private credit (obtainable at reasonable rates) were insufficient. [4/] Non-physical disaster loans could be made for any amount up to the pollution control cost in question, and for maturities extending to 30 years. [5/] Interest rates were recently running at about 9 1/4 per cent. SBA regulations make special mention of compliance with Clean Air Act requirements as creating eligibility to apply for these economic-injury loans, [6/] though presumably other pollution control laws would have also provided grounds for eligibility.

2/ 15 U.S.C. sec. 636(b)(5).

3/ 15 U.S.C. sec. 636(g), added by section 8 of the Federal Water Pollution Control Act Amendments of 1972, Pub. Law 92-500.

4/ 13 C.F.R. sec. 123.2(b)(1).

5/ 13 C.F.R. sec. 123.8.

6/ 13 C.F.R. sec. 123.2(b)(3)(iv).

The Omnibus Budget Reconciliation Act (OBRA) enacted on August 13, 1981, works several changes in the above. In place of the many non-physical disaster loan provisions of the Small Business Act, OBRA substitutes a single consolidated authority that appears to cover much the same ground -- at least it appears to continue the repealed authorities in sections 7(b)(5) and 7(g). 7/ The new provision allows loans --

> to assist any small business concern in effecting additions to, alterations in, or reestablishment in the same or a new location of its plant, facilities, or methods of operation made necessary by direct action of the Federal Government or as a consequence of Federal Government action or to meet requirements or restrictions imposed on such concern under any Federal law ... or any State law enacted in conformity therewith, ... if the Administration determines that such concern is likely to suffer substantial economic injury ... without assistance under this paragraph 8/

But while the substantive authority for pollution control loans seems to remain, SBA is expressly prohibited in OBRA from implementing the new provision in fiscal years 1982 through 1984. 9/ So, no further loans for the pollution control expense of small business can be made by SBA until October 1, 1984.

Guaranteed Surety Bonds

Of tangential relevance to pollution control financing is the SBA's surety bond guarantee program, authorized by the Small Business Investment Act (SBIA). 10/ Under this program, SBA may guarantee any surety company against loss as the result of a breach of the terms of, among other things, performance bonds. SBA deals directly with the surety company, not at all with the small business

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7/ Sections 7(b)(5) and 7(g) of the Small Business Act, among other non-physical disaster loan authorities, are repealed by section 1913 of OBRA.

8/ New section 7(b)(3) of the Small Business Act, as added by OBRA sec. 1913.

9/ OBRA sec. 1905.

10/ SBIA sec. 410 and 411, 15 U.S.C. secs. 694a and 694b.

or the contractor to whom the surety company issues the performance bond. Eligible performance bonds are those not exceeding $1 million in face value.[11/] The surety must pay SBA a guarantee fee equal to 20 percent of the bond premium,[12/] making the program self-sustaining. OBRA sets the authorized ceiling for bond guarantees under this program at $1.4 billion.[13/]

We are informed by the SBA office that administers the surety bond program[14/] that many applications are received from sureties in connection with contractors required to provide performance bonds as part of an agreement to construct pollution control facilities. The program, however, extends to performance bonds of all types, whether pollution-related or not.

Guaranteed Pollution Control Revenue Bonds

Under a 1976 amendment to the Small Business Investment Act,[15/] SBA is authorized to assist small businesses in obtaining tax-exempt pollution control bond financing that might otherwise not be available to them. The financing of pollution control equipment, Congress recognized, creates a particular hardship for small businesses, which have limited capital resources and financing options. Small businesses, lacking the name recognition and established creditworthiness of large corporations, may be effectively barred from the long-term, tax-exempt bond market.

The 1976 amendment eliminates the disparity between small and large businesses by empowering SBA to insure payments by small businesses under the purchase or lease contracts that secure pollution control bonds:

11/ 13 C.F.R. sec. 115.8(a)(3), 46 Fed. Reg. 46116 (September 17, 1981).

12/ Id. at sec. 115.9(b).

13/ OBRA sec. 1905.

14/ SBA Office of Special Guarantees, Arlington, Va. 235-1907.

15/ Pub. Law 94-305.

> The Administration may, whenever it determines that small business concerns are or are likely to be at a ... disadvantage with other business concerns with respect to the planning, design, or installation of pollution control facilities, or the obtaining of financing therefor (including financing by means of revenue bonds ...), guarantee the payment of rentals of other amounts due under qualified contracts. 16/

The SBA guarantee must be for the full amount of the payment due under the qualified contract, but may only be issued where there is a reasonable expectation that the small business in question will fully perform under the contract. 17/ In addition, the small-business applicant must be independently owned and operated, not dominant in its field, eligible under general SBA policy, have been in operation for at least five years, and have a history of profitable operations during any three of the five years preceding the date of application (or demonstrate the equivalent). 18/

The required financing to be guaranteed shall not exceed $5 million in principal. 19/

The guaranteed pollution control revenue bond program at SBA is a self-sustaining program --- i.e., receives no appropriations. All expenses and payments under the program (excluding administrative expenses) are paid from a revolving fund. This fund is maintained within the U.S. Treasury, receives all monies paid to the SBA Administrator, and is available for purposes of the guarantee program without fiscal year limitation. 20/ The Omnibus Budget Reconciliation Act increased SBA's authorized ceiling for guarantees under

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16/ SBIA sec. 404(b) 15 U.S.C. sec. 694-1(b).

17/ Id.

18/ 13 C.F.R. sec. 111.4.

19/ 13 C.F.R. sec. 111.7(b).

20/ SBIA sec. 405, 15 U.S.C. sec. 694-2.

the program from $110 million in fiscal year 1981 to $250 million for fiscal years 1982 through 1984. [21]

Economic Development Loans

The Public Works and Economic Development Act of 1965 (PWEDA) [22] charges the Department of Commerce, acting through the Economic Development Administration (EDA) with responsibility for stimulating industrial growth and economic development in economically depressed areas. Two programs of the EDA, while not directly related to the financing of polution control equipment, can in certain instances provide financial assistance for that purpose.

Under section 202 of the Act, [23] EDA is empowered to aid in financing the purchase of industrial facilities (including equipment) and the alteration, conversion, or enlargement of existing facilities through loans and loan guarantees. As noted, the program is administered for the prime purpose of achieving the long-range economic development goals of the Act -- creating jobs, increasing incomes, and diversifying local economies -- and not to underwrite commercial ventures. [24] But if a firm is located in a designated "redevelopment area" [25] and is likely to be shut down -- causing a loss of jobs -- for failure to comply with environmental requirements, then pollution control expenditures may well qualify for section 202 assistance.

21/ OBRA sec. 1905.

22/ 42 U.S.C. sec. 3121 et seq.

23/ 42 U.S.C. sec. 3142.

24/ 13 C.F.R. sec. 306.1(b).

25/ Section 401 of PWEDA, 42 U.S.C. sec. 3161, requires EDA to designate as redevelopment areas those regions where any of several specified indices of economic distress are found.

The utility of the section 202 loan program to small businesses is constrained by the EDA's policy that requests for loans less than $500,000 will be turned over to the SBA.

Projects must be approved for assistance by a State or local economic development agency and may only be financed under PWEDA if the financial assistance applied for is not available from private lenders or other Federal agencies.[26/] Loan assistance may not exceed 65 percent of the project cost, and guarantees may not exceed 90 per cent of the outstanding unpaid balance of the loan.

While EDA continues to exist as a formal entity, the Administration position[27/] is to seek no fiscal year 1982 appropriations for new loans or guarantees, but rather to obtain only enough funds to allow EDA to honor commitments under existing loan guarantees and to protect collateral obtained in foreclosures on defaulted loans.

Title IX of PWEDA sets up a program of "Special Economic Development and Adjustment Assistance" for the purpose of --

> help[ing] State and local areas meet special needs arising from actual or threatened severe unemployment arising from economic dislocation, including unemployment arising from actions of the Federal Government and from compliance with environmental requirements which remove economic activities from a locality 28/

Under the program, EDA makes grants to States and local communities, not to business concerns. These public bodies may then, in turn, distribute the Federal money to businesses through loan guarantees. No grants may be made

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26/ 42 U.S.C. sec. 3142(b).

27/ As conveyed to us by sources at EDA.

28/ PWEDA sec. 901, 42 U.S.C. sec. 3241.

by a governmental recipient of Title IX funds to a private profitmaking entity. [29]

As with section 202 loans, the Title IX program may be inaccessible to most small businesses. EDA regulations state that preference in the approval of Title IX grants will be given to situations where at least 500 jobs (or a significant percentage of jobs in the area) are threatened. [30]

The appropriation authorization for fiscal year 1982 is $33 million. [31] An appropriation bill for the period has not yet been enacted.

Rural Industrialization Assistance

Section 310B of the Consolidated Farm and Rural Development Act (CFRDA) [32] authorizes the Secretary of Agriculture, through the Farmers Home Administration (FmHA), to provide various forms of financial assistance to businesses located in rural areas.

Section 310B(a) creates a Business and Industrial Loan Program. Under it, FmHA makes and insures loans to, among other entities, private profitmaking organizations for the purpose of --

> improving, developing, or financing business, industry, and employing and improving the economic and environmental climate in rural communities, including pollution abatement and control .... [33]

The authority to "insure" loans in 310B(a) includes the authority to guarantee loans. [34] CFRDA sets a $1.5 billion authorization ceiling on loans under this

---

29/ PWEDA sec. 903(a)(2)(A), 42 U.S.C. sec. 3243(a)(2)(A).

30/ 13 C.F.R. sec. 308.4(b)(2).

31/ OBRA sec. 1821(a)(11).

32/ 7 U.S.C. sec. 1932. This section was added by a 1972 amendment commonly known as the Rural Development Act, Pub. Law 92-419.

33/ See regulations at 7 C.F.R. sec. 1980.401 et seq.

34/ CFRDA sec. 343, 7 U.S.C. sec. 1991.

program in fiscal year 1982,[35] but the authorizations do not take effect until approved in separate measures reported from the congressional appropriations committees.[36]

FmHA reports that the Administration will seek a zero authorization ceiling for loans and guarantees made in FY 1982 (after expiration of the continuing resolution).

CFRDA section 310B(b) establishes what seems at first glance to be a useful program for the small business:

> "The Secretary [of Agriculture] may make grants, not to exceed $50,000,000 annually, to eligible applicants under this section for pollution abatement and control projects in rural areas. No such grant shall exceed 50 per centum of the development cost of such a project.

FmHA regulations appear to permit profitmaking entities to avail themselves of this program.[37] However, FmHA informs us that this program has never been funded by Congress.

Grants for private business enterprises under CFRDA section 310B(c) are made only to public bodies. These funds are used by the public body to facilitate site acquisition and development, and street and utility extensions, enabling private business to locate in rural areas. The program is a small one; moreover, the Administration has reportedly requested zero funding for fiscal year 1982.[38]

35/ CFRDA sec. 346(b)(2)(B), 7 U.S.C. sec. 1994(b)(2)(B). Of the $1.5 billion, $100 million may be for insured loans and $1.4 billion may be for guaranteed loans, "with authority to transfer amounts between categories." Id.

36/ CFRDA sec. 346(a), 7 U.S.C. sec. 1994(a).

37/ 7 C.F.R. sec. 1980.402(a). In referring to "eligible applicants under this section," section 310B(b) suggests that entities eligible under 310B(a) are also eligible (for the specified purposes) under 310B(b). The cited regulation is, on its face, a definition for only 310B(a).

38/ See regulations at 7 C.F.R. sec. 1942G (recodified from sec. 1823.450 in 1980 edition of 7 C.F.R.).

Innovative Treatment System Grants

Pursuant to section 105(c) of the Clean Water Act, [39] EPA may make grants to, or enter into contracts with, industry for research and demonstration projects involving new water pollution control methods. The project must develop or demonstrate a new or improved method of treating industrial wastes or otherwise prevent pollution by industry, and must have industrywide application. Grants under this authority may not exceed 75 per cent of the cost of the project. [40]

Section 103(a)(2) of the Clean Air Act [41] allows EPA to provide financial assistance to businesses as part of a mandated national R&D program for the prevention and control of air pollution.

Section 104(a)(2) of the Clean Air Act [42] authorizes EPA to contract with businesses for various costs in connection with the researching and development of innovative air pollution controls applicable to fuel burning. These costs include:

> part of the cost of securing for R&D new or improved air polution control devices having industrywide application;
>
> part of the cost of developing low emission alternatives to the internal combustion engine;
>
> the cost of purchasing vehicles for R&D, and testing.

EPA may also "assist in meeting the cost" of new or improved demonstration plants or processes which hold promise of achieving fuel-related objectives of the Clean Air Act. [43]

39/ 33 U.S.C. sec. 1255(c).

40/ 33 U.S.C. sec. 1255(g).

41/ 33 U.S.C. sec. 7403(a)(2).

42/ 42 U.S.C. sec. 7404(a)(2).

43/ 42 U.S.C. sec. 7404(a)(4).

Appropriation authorizations for R&D under the Clean Air Act and Clean Water Act are not tied to specific provisions of these acts. Hence, it can only be reported that the Administration's proposed budget for fiscal year 1982 asks for $35.5 million in new obligation authority for extra-Agency R&D under the Clean Air Act, and $24.5 million in new obligation authority for extra-Agency R&D under the Clean Water Act. These figures are essentially unchanged from the amounts obligated under each act in fiscal year 1981. In the past, however, the overwhelming share of these funds has gone to nonprofit entities. 44/

Robert Meltz
Legislative Attorney

44/ As reported to us by the Comptroller's Office, EPA.

Exhibit 2.—Federal Income Tax Incentives for Financing.

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FEDERAL INCOME TAX INCENTIVES FOR FINANCING THE PURCHASE AND REPLACEMENT OF SMALL BUSINESS POLLUTION CONTROL

by

Howard M. Zaritsky
Legislative Attorney
American Law Division
October 15, 1981

FEDERAL INCOME TAX INCENTIVES FOR FINANCING THE PURCHASE AND REPLACEMENT OF SMALL BUSINESS POLLUTION CONTROL

This report summarizes the various provisions of Federal income tax law which facilitate financing of the purchase and replacement of pollution control facilities of small businesses. It includes a discussion of the applicable rules on tax exempt state and local industrial development bonds and the capital cost recovery rules applicable to such facilities.

Tax Exempt State and Local Bonds. The interest received by a taxpayer on a State or local bond is generally exempt from Federal income taxes.[1/] The interest received by a taxpayer on a State or local bond, the proceeds of which are used to finance benefits for private parties, is not tax exempt. Such bonds are referred to as industrial development bonds and there are several exceptions to the general rule of their taxability.[2/]

Two classes of exempt industrial development bonds are relevant to the question of Federal tax incentives for financing pollution control by small businesses. First, interest on State and local bonds is exempt from tax if the bond proceeds are used to finance "air or water pollution control facilities."[3/] Second, the interest on certain small issues of industrial development bonds is exempt from tax without regard to the purpose to which the proceeds are put.[4/]

1/ Int. Rev. Code of 1954 § 103(a).

2/ Int. Rev. Code of 1954 § 103(b).

3/ Int. Rev. Code of 1954 § 103(b)(4)(F).

4/ Int. Rev. Code of 1954 § 103(b)(6).

The exemption of interest on "air or water pollution control facilities" bonds could arguably be construed to permit State and local governments to issue debt instruments in order to finance pollution control efforts of small businesses. The Treasury Department's regulations, however, say that if bond proceeds are used to finance the purchase of equipment which is partially designed to reduce air or water pollution and partially to do general manufacturing, only the "incremental cost" of the property over the portion expended for manufacturing purposes is spent for an exempt purpose. An expenditure is made for a significant purpose other than the control of pollution if it results in an increase in production or capacity, or a material extension of the useful life of a manufacturing or production facility.5/

Under this regulation, the I.R.S. has taken a restrictive view of what expenditures qualify as air or water pollution control facilities. The I.R.S. has rejected the concept that such bonds may be used to replace the manufacturing efficiency losses caused by other pollution abatement or control actions. The I.R.S. has denied tax exempt status for the interest on State and local bonds used to finance the following:

(1) the cost increment of a public utility's new electric generating unit that covers power generation capacity required to operate pollution control facilities;6/

(2) the cost of installing two new recovery boilers, used to recover valuable chemicals from residue, installed in a paper mill to replace the

---

5/ Treas. Regs. § 1.103-8(g)(2).

6/ Rev. Rul. 75-332, 1975-2 C.B. 39.

operating capacity lost because of the reduction in operating levels of existing boilers which did not comply with air pollution requirements;[7]

(3) the cost of a smokestack for steam electric generators of public utilities to be constructed to disperse pollutants at high altitude, although certified by a state agency as in furtherance of pollution abatement;[8] and

(4) An advance design acid plant meeting Federal and State ambient air standards but without specific equipment to remove, alter, dispose, or store pollutants, contaminants, wastes, or heat, constructed to replace existing air polluting plants.[9]

However, the I.R.S. has also allowed a tax exemption for interest paid on bonds issued to finance pollution control facilities installed as backup to a qualifying facility, enabling a plant to maintain production when the primary facility is inoperative.[10]

The I.R.S. position appears to be based on an attempt to limit the exempt financing to that portion of any expenditure which fits precisely within the statutory exception for "air or water pollution control facilities."[11] In the Revenue Ruling 75-334, discussed above, the I.R.S. said that the

---

7/ Rev. Rul. 75-334, 1975-2 C.B. 371.

8/ Rev. Rul. 75-167, 1975-1 C.B. 40.

9/ Rev. Rul. 75-404, 1975-2 C.B. 39.

10/ Rev. Rul. 78-421, 1978-2 C.B. 100

11/ The legislative history is of relatively little assistance in this regard. The basic provisions on industrial development bonds were added by Senate floor amendment to the Revenue and Expenditure Control Act of 1968 by Senator Ribicoff, and while there was extensive debate, this issue was not directly addressed. See 114 Cong. Record 8147 (March 28, 1968).

boilers purchased with the bond proceeds did not remove pollution from air or water, but rather improved the company's manufacturing processes to compensate for the impact of pollution restrictions.

Therefore, it appears that the I.R.S. does not generally permit tax exempt financing of the major portion of the cost of a change in a manufacturing process which is designed in part to improve manufacturing operations and in part to reduce pollution.

The second possible avenue of tax exempt financing of small businesses pollution control facilities is the small issue industrial development bond. A State or local government may issue up to $10 million in bonds to pay for capital expenditures without respect to the nature of the expenditures.[12/] In this regard, a State or local government could finance small business pollution control facilities which would not be eligible for financing under the general exception for "air or water pollution control facilities."

A recent I.R.S. ruling, however, raises some questions regarding the general breadth of the small issue exception. In Revenue Ruling 81-216,[13/] the I.R.S. said that multiple government bond issues could be treated as part of the same issue for purposes of the $10 million limitation based on all of the relevant facts and circumstances. Specifically, the I.R.S. said it would consider whether the bonds were to be sold at substantially the same time, under a common marketing plan, and at substantially the same

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12/ Int. Rev. Code of 1954 § 103(b)(6).

13/ Rev. Rul. 81-216, I.R. 81-98 (August 24, 1981). The I.R.S. has announced that persons with pending transactions adversely affected by the ruling may seek relief by request to the I.R.S., asking for the ruling not to be applied retroactively. I.R. 81-102 (September 3, 1981).

interest rate. The I.R.S. would also consider whether a common or pooled security would either be used or be available to pay debt service on the bonds. If multiple bond issues are aggregated and treated as a single issue, the amount of bonds which a State or local government could issue to finance small business pollution control could be reduced significantly.

Cost Recovery of Pollution Control Expenditures. The capital costs of small business pollution control expenditures may be recovered for Federal income tax purposes through the investment tax credit and depreciation or amortization deductions.

The full ten percent investment tax credit is available for depreciable or amortizable pollution control devices purchased by the taxpayer for use in the taxpayer's trade or business.[14/] This is the maximum investment tax credit available for business property.

Taxpayers can recover the cost of pollution control facilities under the Accelerated Cost Recovery System (A.C.R.S.) introduced by the Economic Recovery Tax Act of 1981.[15/] Under A.C.R.S., the cost of capital improvements to real estate can be recovered at an accelerated rate over 15 years and the cost of capital equipment at an accelerated rate over five years. Before the 1981 Act, a taxpayer could elect to amortize the cost of pollution control facilities over a five year period.[16/] It is unclear whether the 1981 Act

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14/ Int. Rev. Code of 1954 § 46(c)(5).

15/ Int. Rev. Code of 1954 § 168, added by Pub. L. 97-34, 97th Cong., 1st Sess (1981).

16/ Int. Rev. Code of 1954 § 169.

effectively supersedes the former five year elective amortization,[17/] though in virtually every instance the 1981 Act method should produce larger deductions in the early years.

Howard M. Zaritsky
Legislative Attorney
American Law Division
October 15, 1981

17/ See Luscombe & Chevis, "Faster, Simpler Depreciation Rules Available for all Property under the New Tax Legislation," 55 Journal of Taxation 194, 195, fn. 3 (October, 1981).

APPENDIX B.—STATEMENT OF COUNCIL OF POLLUTION CONTROL FINANCING AGENCIES

COUNCIL OF
POLLUTION CONTROL FINANCING AGENCIES

Officers and Directors

President
RONALD BEAN
Executive Director
Illinois Environmental
Facilities Financing
Authority

Vice President
STEVEN BARROUK
Executive Director
Allegheny County
Industrial Development
Authority

Secretary/Treasurer
TOM MCKEWEN
Director
Maryland Environmental
Service

E. JACK DAVIS
General Manager
Gulf Coast Waste
Disposal Authority

JAMES A. DAVIS
Chairman
Missouri State
Environmental
Improvement Authority

ROBERT FITZPATRICK
Executive Director
Wayne County Economic
Development Corporation

CURTIS SOHL
Executive Director
Ohio Air Quality
Development Authority

JESSE UNRUH
Chairman
California Pollution
Control Financing
Authority

H. LAWRENCE FOX
Dawson, Riddell,
Fox, Hornyd & Wilson

MURRAY HUTCHINSON
IT Corporation

DORSEY LYNCH
Vice President
First Boston Corporation

J. C. MCKENZIE
Vice President
Salomon Brothers

ROBERT B. MORAN
Corporate Finance Manager
Atlantic Richfield Company

National Office

RON M. LINTON
JAMES B. YOUNG
Executive Directors

September 29, 1981

Rep. Berkley Bedell
Chairman
Subcommittee on Energy and Environment
Committee on Small Business
U.S. House of Representatives
Room B363
Rayburn House Office Building
Washington, D.C. 20515

Dear Mr. Bedell:

I am writing on behalf of the state and local agencies who comprise the Council of Pollution Control Financing Agencies in support of your oppositio to Revenue Ruling 81-216, issued by the Treasury Department Augus 24, 1981.

The ability to aggregate small issue bonds is a key to providing sorely needed capital for small businesses who are faced with the cost of meeting environmental mandates. Council member agencies, who work for the increased availability of financing to achieve national environmental goals, have strongly supported the Small Business Administration's Pollution Control Loan Guarantee Program, which has an outstanding record of providing the necessary guarantees for small business pollution control loans.

The Congress recognized this when, with the support of your committee, it increased the ceiling of this program as part of the first budget resolution. It should be noted that due to the modest fees to SBA, and the excellent track record of the program, it constitutes a net addition to the Federal treasury.

The impact of the revenue ruling is to undermine the efforts of the state and local agencies who compromise the Council, and who have in many cases made great efforts to seek out small businesses to inform them of this program, and then to guide them through the complexities of securing the financing they need to comply with pollution control orders.

The Congress, in establishing this program, recognized that aggregating financings into umbrella financings under the SBA guarantee would be a key to its success and provided for that to occur. The Treasury ruling seems to fly in the face of statutory language, but that has not dissuaded the department from its efforts.

I must also comment on the unbending response of the Administration to the appeal of a delegation of governors who met with the President and voiced their concern over the ruling. After being told the ruling would be withdrawn, they later learned that it is being replaced by a proposed regulation, backdated to August 24, so that the freeze will continue

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in effect throughout the period of proposal and comment.

You are well aware of the impact on other financings which this policy threatens. You should additionally be aware that when pollution control mandates are in question, small firms face deadlines which prevent them from waiting for other financing to become available, or for market rates to go down. If these firms cannot manage to structure financings to fit the straightjacket imposed without warning by the revenue ruling, they will face stark decisions on whether to continue facilities, and jobs.

I am enclosing specific examples of how firms have been aided in the attached statement, given before hearings on the program earlier this year in the U.S. Senate Committee on Small Business.

Although the Council will support legislative efforts to overturn the ruling, we feel that what has been done administratively can be undone the same way, far more quickly. Therefore, I want to let you know of our backing for your letter to Secretary Regan, and our availability for any further information and other assistance we can provide.

Sincerely,

Ronald Bean

Ronald Bean
President

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APPENDIX C.—ADDITIONAL STATEMENT OF NATIONAL SOLID WASTES MANAGEMENT ASSOCIATION

NATIONAL SOLID WASTES MANAGEMENT ASSN. NSWMA

National Solid Wastes Management Association

1120 CONNECTICUT AVENUE N.W. • SUITE 930 • WASHINGTON D.C. 20036
TELEPHONE (202) 659-4613

EUGENE J. WINGERTER
EXECUTIVE DIRECTOR

November 12, 1981

The Honorable Berkley W. Bedell
U.S. House of Representatives
2440 Rayburn House Office Building
Washington, D.C. 20515

Dear Mr. Bedell:

We appreciated the opportunity to testify before your subcommittee on November 4 on pollution control financing problems for small businesses. In our testimony, we concentrated for the most part on the types of operations our small business members are apt to be involved in; recycling, collection, and some disposal. Our membership does include some very large corporations (three U.S. firms and one Canadian) and many medium-sized businesses that do not fall within the current SBA definition of small. The large and medium-sized firms are the ones most likely to be involved in high technology resource recovery, that is waste-to-energy projects. Because of this, we did not dwell on waste-to-energy projects in our testimony.

However, Mr. Molinari was particularly interested in waste-to-energy projects and we thought some additional information on their difficulties might be useful to you. The viability of this industry is certainly of paramount concern to us.

The economic feasibility of waste-to-energy projects depends as much on the "waste" side as on the "energy" side. Companies who are now the leaders in providing major systems for communities are also the leaders in the solid waste disposal business. They are not, for the most part, companies unfamiliar with garbage who chought resource recovery was a good investment opportunity. Our Association and these firms view waste-to-energy primarily as a way to manage municipal waste, with energy sales reducing the total cost of disposal if possible. In public policy terms, even though waste-to-energy facilities are indeed a source of renewable, domestic fuel, they are even more the means to reduce our reliance on publicly unpopular new landfills. Landfilling, however, remains and will remain for some time a cheaper disposal method where it is available. Therefore, the full complement of federal incentives—energy tax credits, tax free industrial development bonds--are needed along with those incentives available to other competing investments--investment tax credits and accelerated cost recovery. The

• COLLECTION COMMITTEE
• INSTITUTE OF CHEMICAL WASTE MANAGEMENT
• INSTITUTE OF RESOURCE RECOVERY
• INSTITUTE OF WASTE EQUIPMENT DISTRIBUTORS
• INSTITUTE OF WASTE TECHNOLOGY
• LANDFILL COMMITTEE
• WASTE EQUIPMENT MANUFACTURERS INSTITUTE

88-724 O—82——7

loss of the availability to use tax free pollution control IDB's and energy tax credits would not be compensated for by provisions in the Economic Recovery Act of 1981.

Please feel free to add this letter to the record if you feel it would be appropriate.

Sincerely,

Michael B. Cooper
Director, Equipment and
Technology Programs

MBC/bjm

APPENDIX D.—STATEMENT SUBMITTED BY THE CAST METALS FEDERATION

JOHN P. HILER
THIRD DISTRICT, INDIANA

COMMITTEES:
GOVERNMENT OPERATIONS
SMALL BUSINESS

WASHINGTON OFFICE:
1338 LONGWORTH HOUSE OFFICE BUILDING
WASHINGTON, D.C. 20515
(202) 225-3915

DISTRICT OFFICE:
RIVER GLEN OFFICE PLAZA
801 MONROE STREET, ROOM 130
SOUTH BEND, INDIANA 46601
(219) 234-4431

Congress of the United States

HOUSE OF REPRESENTATIVES
WASHINGTON, D.C. 20515

November 10, 1981

Honorable Berkley Bedell, Chairman
Subcommittee on Energy, Environment,
Safety, and Issues Affecting
Small Business
B 363 Rayburn HOB
Washington, D.C. 20515

Dear Berkley:

Enclosed with this letter is written testimony prepared by the Cast Metals Federation on the subject of pollution control financing for small business. I write to ask that the testimony be included in the record of the hearing held last Wednesday, November 4, 1981.

Thank you for your time and consideration.

Sincerely,

JOHN HILER
Member of Congress

JH/ts

STATEMENT OF THE
CAST METALS FEDERATION
(CMF)
TO THE SUBCOMMITTEE ON ENERGY, ENVIRONMENT AND SAFETY
OF THE
COMMITTEE ON SMALL BUSINESS
U.S. HOUSE OF REPRESENTATIVES
ON THE SUBJECT OF
POLLUTION CONTROL FINANCING FOR SMALL BUSINESS
NOVEMBER 6, 1981

This statement is submitted on behalf of the Cast Metals Federation for inclusion in the record of the hearings on Pollution Control Financing for Small Business. The Cast Metals Federation (CMF) is composed of the five major trade associations in the foundry or metal casting industry. These associations are the Iron Castings Society, National Foundry Association, Steel Founders' Society of America, Non-Ferrous Founders' Society, and Investment Castings Institute. Member companies of these organizations produce 90 percent of this country's castings tonnage.

INDUSTRY PROFILE

The foundry industry is one of the nation's most basic industries comprising some 4,400 units capable of producing over 19 million tons of all types of castings annually having a value in excess of $21 billion.

Allowing for value added by manufacturing, the foundry industry ranks fifth in the nation. It employs over 400,000 production workers. Eighty (80) percent of the firms in the industry employ less than 100 persons. Whether it is energy, mass transportation, productivity improvement, or national defense -- castings are involved.

Ferrous and non-ferrous foundries (excepting automotive supplier foundries) are today operating at about 75 percent of capacity. Automotive iron casting foundries are operating at 40-50 percent of capacity due to downsized cars and increased import penetration. During this down-turned economy and tight money situation, total industry tonnage in 1980 for all metals (ferrous and nonferrous) fell below 14 million tons. No dramatic improvement is seen in 1981.

The foundry industry is frequently called "the front end of the industrial system" -- and with good reason: Foundry products -- or castings -- are absolutely necessary in the manufacture of valves, machine frames, automotive engines and transmissions, compressors and pumps, gears and guideways, turbine parts, mining and earthmoving equipment, and military hardware.

Foundries are therefore particularly sensitive to changes in the capital goods sector of the economy, as well as consumer demands for durables, particularly passenger cars.

SUPPORT FOR IRB & SBA PROGRAMS

The Cast Metals Federation supports the continuation of industrial revenue bond programs and Small Business Administration loan guarantee programs for pollution control financing. CMF believes these programs are essential to foundries and other small businesses required to install anti-pollution devices to comply with federal, state or local environmental standards which are being proposed, adopted and enforced with increasing diligence.

Foundries have spent -- and continue to spend -- abnormal amounts of capital to meet the mandatory requirements. Expenditures for OSHA and EPA equipment amount to approximately 30-35 percent of total capital expenditures. This financial drain forces most foundry managers to search for the necessary additional capital to make much needed productivity improvements.

The growing restrictive nature of air emission regulations, tighter emission limits, commitments to secondary air quality standards, and visible emission limitations will continue to be felt by older existing facilities which

are still required for operation into the future. Modernization and replacement programs for productive equipment will suffer unless reasonable financing to qualified small business is possible.

IRB's and SBA loan guarantees have been used by many foundries for financing growth and expansion. Small business, and particularly closely-held companies, do not have access to equity capital for such expansion. Only debt financing is possible and at current interest rates meaningful expansion is impossible to justify. IRB's and SBA have filled this need and should not be curtailed or eliminated.

In the study entitled "Small Business Performance in the Regulated Economy", Kenneth Chilton and Murray Weidenbaum focused on foundries, as follows:

"One of the better documented cases of the adverse impact of federal regulations on a large number of small firms is furnished by the foundry industry. In the late 1960's this industry began to lose small plants, those that specialized in small orders of less than 400 pieces a year, due to the combined effects of economic recession and EPA regulation. The castings produced by these foundries are critical for production of limited quantity capital equipment. The size of the mandated EPA emission control expenditures for many of the foundries exceeded the net worth of the entire operation. In the period 1968

through 1975 there were 350 verified foundry closings. Thirty-four percent of these closings cited EPA regulations as the partial or total cause for the foundry closure."

CASE STUDIES

The burden of environmental laws falls heaviest on small business. Capital and operating costs for pollution control facilities do not yield a direct economic return. Indeed, in the case of a gray iron foundry in Maryland, the damage has already been done. The foundry's president offered this case study:

"In 1970, we were a small business, approximately 200 employees and sales of $5 million engaged in the gray iron foundry business. Maryland's Control of Air Pollution regulation 43P04 had been approved by the Environmental Protection Agency, and they were on our backs for a "plan of compliance" with regard to a stationary pollution source, an iron melting cupola... for about $50,000 we would have reduced emissions from our cupola by 90 percent, but that wasn't good enough. We had to reduce it by 98 percent.

"We spent more than $100,000 of our own cash and borrowed (leased) $300,000 more to put a heat exchange/cyclone/baghouse on our cupola. The maintenance and increased costs were horrible...

"After about five years of fighting this, technology had improved in electric furnaces. We bought one with a $500,000 SBA loan. Our working capital was so depleted by this time that the SBA loaned us another $500,000 under a recovery of working capital/air pollution ruling...

"I conservatively estimate this whole thing cost us over $1 million and the remains of the scrapped air pollution equipment, abandoned some six years ago, are rusting in a field. The last payment of this equipment is due in 1982."

A small, family-owned iron jobbing foundry in Illinois constructed a new cupola and a required particulate control system during the period 1969 to 1971. At that time, the capital cost of the hydro-filter particulate controls was nearly four times the cost of the cupola used in meting iron into various castings. The new cupola and particulate controls had been granted construction and operating permits by the state EPA.

During intervening years, however, the state of Illinois adopted an hourly carbon monoxide (CO) emission limitation for foundry cupolas. In 1977 tests made on a voluntary basis showed that the foundry's CO emission rate exceeded the state limit. The state in turn found the foundry to be in technical non-compliance with the state rule and denied renewal of the cupola operating permit. The foundry then incurred additional expense

filing a petition before the state to receive a variance until the state modified its rule to allow exceptions to the current emission limitations.

Compliance with the state's CO emission limitation in this situation is especially burdensome because there is no definite proof that the source is exceeding the national ambient air quality standard for CO. It is unknown whether or not the state or EPA have performed any modeling calculations to verify an actual CO ambient standard violation.

The foundry further learned that adding CO controls to meet the state emission limitation would necessitate buying a new cupola, constructing a new stack and replacing the particulate control system. The cost of these new CO and particulate controls was estimated to be three times the cost of a new cupola. Such an investment is projected to greatly exceed the foundry's net after-tax income for one year.

IRB & SBA CRITICISM ANSWERED

IRB critics cite exagger ated revenue losses and funding abuses. A counter-argument to these claims was offered in a letter to a foundryman constituent by Rep. Edward J. Markey as follows:

"Critics of these bonds base their arguments on two beliefs, both of which are false. First, opponents of IRB use argue that these tax-free bonds are a substantial drain of the federal treasury.

They cite a Congressional Budget Office study which concludes that the government loses $30 million in revenue for each $1 billion of bonds issued. (About $8.4 billion of the bonds were issued in 1980). Another study by Dr. Roger Kormendi at the University of Chicago, however, concludes that the revenue loss from IRB's is only $4.2 million per $1 billion. Clearly, this revenue loss is more than offset by the increased economic development sparked by the bonds. Critics of the bonds also argue that the bonds are used to fund projects of questionable merit, such as massage parlours or Macdonalds restaurants which don't need the tax break to finance new franchises. There is no question that there have been some abuses of IRB's, but it would be a great mistake to arbitrarily restrict IRB's from a federal level simply because some states have been lax in administering them."

The value of SBA financing programs was enthusiastically described by Sen. S.I. Hayakawa as follows:

"Through this bond guarantee program, SBA has guaranteed in excess of $200 million for more than 170 small companies, employing nearly 20,000 people. When the program was enacted in 1976, a revolving fund of $15 million was created. Guarantee fees charged to applicants are paid into the fund and any liabilities through defaults would be paid from it. To date, the fund has grown to approximately $31 million, and only one default has occured. Investment authority was not granted to the SBA

until fiscal year 1981, and in the first six months, SBA had made over $738 thousand through investments."

CONCLUSION

CMF urges this subcommittee and the Congress to work for the continued availability of these effective financing tools for small business. Foundries are forced to invest in unproductive pollution control equipment to meet government requirements while being simultaneously faced with the need to invest for productivity improvement in order to survive.

The Administration's decision to lower or eliminate funding levels for these programs should, we believe, be re-examined.

APPENDIX E.—STATEMENT OF THE NATIONAL ASSOCIATION OF METAL FINISHERS

national association of metal finishers
an organization of management executives in the fields of metal finishing and allied arts

HEADQUARTERS
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J. DOLLARD CAREY
111 East Wacker Drive
Chicago, IL 60601

December 2, 1981

The Honorable Berkely Bedell
Chairman
Subcommittee on Energy, Environment and
Safety Issues Affecting Small Business
2440 Rayburn House Office Building
Washington, D.C. 20515

Dear Congressman Bedell:

In view of the recent hearing you held on the subject of pollution control financing, I thought you would be interested in the National Association of Metal Finishers comments to the Internal Revenue Service concerning Revenue Ruling 81-216. As you will recall from our meeting with you last June, NAMF's members face serious financial difficulties in trying to comply with Environmental Protection Agency pretreatment regulations for the metal finishing industry. This proposed ruling only further exacerbates the problem.

Please let me know if you have any questions or require additional information.

Sincerely,

Michael Payne

Michael Payne
Director
Government Relations

Attachment

MP:jjc

national association of metal finishers
an organization of management executives in the fields of metal finishing and allied arts

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Executive Director
J. DOLLARD CAREY

November 25, 1981

Mr. Roscoe L. Egger, Jr.
Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C. 20024

Dear Commissioner Egger:

The National Association of Metal Finishers (NAMF) wishes to express its concern with Revenue Ruling 81-216. It is our understanding that the ruling would prohibit the pooling of multiple lots of small issue industrial development bonds (IDB's) into a single bond issue. Such a ruling would result in the removal of a major source of funding used by the metal finishing industry to finance pollution control equipment. We urge that Revenue Ruling 81-216 be repealed.

NAMF represents an industry comprised of over 9,000 job shop metal finishing firms which provide an absolutely essential service to this country's manufacturing economy. We are, in the truest sense, an industry of small business with an average firm employing 15 to 20 people and capitalized at about $250,000. NAMF feels that it is in a unique position to comment on the IRS ruling since our industry has been in the forefront of activities involving water pollution control requirements. We are among the first industries to be regulated by Federal catagorical pretreatment standards.

The metal finishing industry is currently faced with Federal standards, which by the Environmental Protection Agency's own estimates, would have the devastating impact of forcing approximately 20 percent of our industry to close. While NAMF does not agree with the philosophy and specifics of EPA's catagorical pretreatment standards for our industry and is working to have more reasonable standards adopted by EPA, we are committed to the objectives of the Clean Water Act.

In order to comply with the effective date of the Federal standards (January 28, 1984) and with certain evolving state and local requirements, most of our members must begin planning for and purchasing pollution abatement equipment within the next three to ten months. Small issue industrial revenue bonds represent a major source of funding used by metal finishers to purchase pollution control equipment. For example, in Cleveland, Ohio, there are over 100 plating shops employing about 2,500 persons. As you might expect, these small businesses are finding it extremely difficut to finance the

required pollution abatement equipment and necessary operational changes. However, the Cleveland platers are involved in a creative effort to solve their problem which includes relocating many shops around a centralized pretreatment facility. The availability of composite issues of pollution control bonds is essential to their success. Revenue Ruling 81-216 would deprive those platers of that source of funding. Many of those platers could not obtain conventional financing and would be forced to closed down.

The State of Michigan's Job Development Authority has relied heavily on bonding issues to assist platers in purchasing pollution abatement equipment. There are currently bonding issues pending which, if not acted on, could involve the loss of approximately 550 jobs. This does not take into account secondary impacts that would result, such as increased costs for manufacturing firms which rely on the continued operation of platers.

In addition, the availability of guarantees under the Small Business Administration's Pollution Control Financing Guarantee Program is in serious jeopardy. In fact, it is our understanding that no new loan applications could be processed for funding until Fiscal Year 1983 at the earliest. That program has been a major source of financial assistance to metal finishers using small-issue development bonds. Revenue Ruling 81-215 only exacerbates that problem further.

When one combines the impact of Revenue Ruling 81-216 with the lack of SBA guarantee authority, cutbacks in other potential sources of assistance such as the Economic Development Administration, and overall economic trends, the ability for many of our members to obtain necessary financing becomes extremely difficult if not impossible.

When various pollution control laws were enacted, it was recognized that substantial expenditures would be required to meet enviromental objectives. Further, it was understood that small business would need considerable assistance in complying with the requirements of those laws. Revenue Ruling 81-216 significantly adds to our difficulties in obtaining necessary financing for pollution control equipment. In addition, such as ruling does not support the Administration's stated position of assisting small business.

NAMF agrees that improvement can be made in the Industrial Development Bond program to prevent unnecessary abuses. We urge that any improvements be accomplished through a comprehensive examination of the program, in concert with Congress, and not through IRS rulemaking procedures. We appreciate this opportunity to express our views and please contact me if you have any questions.

Sincerely,

William D Wiggins

William D. Wiggins
President

APPENDIX F.—STATEMENT OF THE SMALL BUSINESS COALITION FOR POLLUTION CONTROL

The Small Business Coalition for Pollution Control

President
Jack L. Schaefer
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Box 1031
Dayton, Ohio 45401
(513) 226-1300

Counsel
Randal C. Teague
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1828 L Street, N.W.
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(202) 822-8200

December 14, 1981

Hon. Berkley W. Bedell
Chairman
Subcommittee on Energy, Environment and
Safety Issues Affecting Small Business
House Committee on Small Business
Washington, D. C. 20515

Dear Mr. Chairman:

The Small Business Coalition for Pollution Control was organized this year to represent the interests of small businesses across the country in the preservation and strengthening of the Small Business Administration's pollution control facilities financing guarantee program.

In this regard, the Coalition supports the work of you and the Committee to assure adequate annual authorization for the program, particularly the November 4 hearing and the Floor colloquies establishing Congressional intent during the consideration of continuing resolutions. That work is essential, and small business knows it.

In support of that November 4 hearing and the issues brought forward through it, the Coalition submits herewith a Statement by its president, Mr. Jack L. Schaefer, and this request that the Statement be made a part of the permanent, printed hearing record.

Respectfully requested,

Randal C. Teague
Counsel

RCT:ms
Enc.

STATEMENT OF MR. JACK L. SCHAEFER, PRESIDENT, THE SMALL BUSINESS COALITION FOR POLLUTION CONTROL, TO THE SUBCOMMITTEE ON ENERGY, ENVIRONMENT & SAFETY ISSUES AFFECTING SMALL BUSINESS, HOUSE COMMITTEE ON SMALL BUSINESS, WASHINGTON, D. C.

CAUGHT BETWEEN A ROCK AND A HARD PLACE: SMALL BUSINESS AND THE SBA'S POLLUTION CONTROL FACILITIES FINANCING GUARANTEE PROGRAM

Mr. Chairman and Members of the Subcommittee:

You are to be congratulated by the small businesses of our country. Congratulated for the effective leadership which you have shown on an issue which directly reaches only a handful of small businesses but which indirectly reaches the quality of life of all our people. I refer to the Small Business Administration's pollution control facilities financing guarantee program, and I refer to the issue of its future.

You are to be congratulated for persuading your colleagues of the continuing and increasing need for this important program, and you are to be congratulated for thereafter making the case known, time after time, to an Administration that is probably rightly reigning in excessive and unnecessary Federal loan guarantees but needing to know which are excessive and unnecessary and which are not.

Chairman Bedell, you and your capable staff are to be thanked particularly. It is not something we will forget.

The Small Business Coalition for Pollution Control

I am Jack L. Schaefer, president of The Small Business Coalition for Pollution Control, on whose behalf this Statement is presented. The Coalition was formed this year to heighten the awarenesses of Congress, the Administration and the public on the alternatives beforethem in determining the future of this SBA program.

The Coalition represent the small businesses which have on the one hand been required to install pollution control facilities and/or equipment in order to meet the air, water and/or solid waste policy objectives of the Federal Government and which on the other hand would face noncompliance with the statutes, regulations, plans and orders reflecting those policies, or a forced sale to a bigger business with greater assets and borrowing leverage, or insolvency if forced to leverage against usually low net worth, in the absence of this SBA "last resort" loan guarantee program. I know this to be true because I am president of a small business, The Specialty Papers Company of Dayton, Ohio, a specialty printing company, which is an applicant fully aware of the potential consequences of a failure by this Administration to act in a timely way in allowing SBA to proceed at the annual level set forth clearly and unmistakably by Congress.

The Coalition is not a permanent trade association. If this authorization issue goes away, we expect to go away too. But, we will be here and intensely active until it does.

The Coalition is represented in the Nation's capital by Randal C. Teague, Counsel to the Washington offices of Vorys, Sater, Seymour and Pease, a Columbus, Ohio general civil practice law firm of national reputation in the environmental compliance area.

The Three Issues

There are really three issues within the issue of the F82 annual authorization level for this program:

1. The level of authorization to be approved for the program by

directive of the administration's Office of Management and Budget (OMB) to SBA;

2. The authorization to SBA by OMB to increase the personnel ceiling within SBA's Pollution Control Financing Section to that level required to close on guarantees equal to the dollar authorization level; and

3. The resolution of the industrial revenue bond (IRB) tax-exemption issues presently before the Administration, OMB and the Department of the Treasury and before the Congress in a way which will permit the continued tax-exemption of pollution control bonds.

If any link in this three-link chain should break, the SBA pollution control facilities guarantee program is endangered, and it cannot go without saying that OMB must be fully aware of this reality.

The Level of FY82 Authorization

Other witnesses have placed in the record of this hearing detailed information with respect to the controversy surrounding the debate between Congress and the Administration over the dollar level of the F82 authorization for this program. In summary, we know -

- Legislation was introduced (S. 580) to increase that authorization level to $250 million and that a hearing of the Senate Committee on Small Business was held on May 7, at which time the Administration opposed the increase and restated its intention to reduce the annual authorizations from $110 million to $100 million in F81 and from $125 million to $95 million in F82.

- The budget enacted in early August, Public Law 97-35,

authorized the SBA Administrator to proceed at an annual authorization level of $250 million in F82.

- The Departments of State, Justice and Commerce appropriations bill, H.R. 4619, enacted by the House and sent to the Senate provides for SBA proceeding at that $250 million authorization level, and, further, that the chairman of the Senate Committee on Appropriations subcommittee, Sen. Lowell P. Weicker, who is also the chairman of the Senate Committee on Small Business, has stated on the Senate Floor his support for that House-passed level.
- The Administration, notwithstanding these enactments and statements of Congressional intent, has authorized SBA to proceed in the First Quarter of F82 with only $40 million, leaving an open question as to whether that $40 million is to be for the F82 year or only the First Quarter thereof and an additional open question as to whether, if it is for only the First Quarter, subsequent quarters will be at that level.
- The Congress has unanimously set forth a clear intent in the Floor consideration of the mid-November Continuing Resolution that the F82 authorization level be no less than $175 million, legislation ultimately vetoed by the President on other grounds.
- The Congress has unanimously set forth a clear intent in the Floor consideration of the subsequent Continuing Resolution, House Joint Resolution 370, that the F82 authorization level be no less than $250 million, the level set forth in S. 580. This Continuing Resolution was signed by the President.

Why has the Administration so strongly opposed the level of funding necessary to carry out this program?

The answer is found, we believe, in the November 5 White House's Office of the Press Secretary "Fact Sheet on Federal Credit/Loan Guarantee Reduction," released the day after this House Committee's public hearing, and we quote:

> "The President today announced a program to reduce new Federal loan guarantee commitments for FY 1982 by $20.3 billion, from $181.4 billion to $161.2 billion. The loan guarantee reductions are a part of the President's efforts to relieve pressure on interest rates and to open the way for sustainable and non-inflationary economic recovery.
>
> " * * * the President's credit reduction proposal is designed to:
>
> - "Dampen inflation expectations and lower interest rates.
> - "Provide the financial market equivalent of a $20 billion reduction in budget outlays * * * .
> - "Curtail the effects of government credit preemption from legitimate private enterprise.
> - "Improve prospects for the expansion of productive investment and the recovery of economic growth.
> - "Facilitate the appropriately restrained conduct of monetary policy.
> - "Represent the first major effort to place substantial restraint on the off-budget explosion of Federal credit demand.
>
> " * * * The Small Business Administration provides credit assistance to small businesses through its * * * 100% indirect guarantee of State pollution control bonds. Under this program, States issue tax-exempt pollution control equipment bonds and the SBA guarantees repayment of loans made to small businesses from the bond proceeds.
>
> "The nearly $1 billion loan guarantee reduction [in SBA's total loan guarantee programs] planned by the President, a 20% reduction below the FY 1982 estimate of slightly less than $5 billion, will, as part of the economic program of lower tax rates, regulatory relief, and anti-inflationary monetary policy, afford more assistance to a wider variety of small businesses than the SBA programs, which focus on only a few. For instance:
>
> " * * * The reduction in guarantee assistance will not have a significant adverse effect on SBA's ability to serve as a

> lender of last resort. It will merely eliminate assistance to those firms at the margin, i.e., those that could obtain credit without Federal assistance and those that would probably never become competitive even with Federal assistance."

Several comments are in order.

First, most small businesses support the President's economic program of reduced Federal spending, reduced corporate and individual taxes, reduced deficits and the crowding out of available capital and the inflationary pressures which deficits can generate, reduction in excessive and unnecessary regulation, and expanded export opportunities. I would think the percentage of small businesses represented by the Coalition which support this economic program would be little, if no, different from the percentage of small businesses as a whole.

No one in business knows the adverse impacts of the Federal Government spending and taxing too much and regulating too much more than a small business. We are the first hit by inflation. We are the first hit by crowding out and high interest rates. We are usually the first into economic slumps and the last out. In competing for available dollars in the market place to borrow, we know of what the White House Fact Sheet speaks. Our concern is that a summary policy statement may reach specific programs not intended to be reached. The Coalition believes that is the case here.

The Coalition believes the November 5 policy, as applied to the SBA pollution control facilities financing guarantee program, will have consequences unintended by the Administration.

Second and in furtherance of that conclusion, we know that the concluding paragraph in the quoted sections of that November 5 Fact Sheet is simply

wrong. Firms which have applied under this program have applied to SBA as, indeed, the lender of last resort. Given the competition for these guarantees and the inadequate levels of annual authorizations, a small business knows that it will not reach "the top of the stack" unless it has exhausted private sector loan opportunities in the absence of such a Federal guarantee. Furthermore, it is not that a small business is marginal in the absence of the indebtedness necessary to bring its plant into environmental policy and program compliance, it is rather that indebting itself further and most often substantially in order to assure that compliance is what makes the business marginal or more marginal. For example, after twenty years of arduous work by me, capable officers and industrious employees, my company, The Specialty Papers Company, now has a net worth of approximately $10 million. Yet, the expenditures necessary to bring our plant into compliance are $3.6 million, to be added to other debt. There is no way, absent a Federal guarantee, that this company could obtain a private sector loan on terms and conditions which would keep it viable.

What the Administration is really arguing here is that Federal loan guarantees create market distortions. It has failed to recognize something as equally important: so, too, do the requirements for expenditures to meet pollution control regulation by the addition of generally non-productive assets. As long as this Government's policy on the one hand is to have such pollution control regulation, its policy on the other must be to assist businesses without private sector loan alternatives to finance the facilities and equipment required.

Small businesses going out of business will have adverse economic impacts too. Reduced corporate taxes paid; reduced Federal payroll taxes

paid; increased unemployment. The Coalition does not believe this is what this Administration desires. Bad economics is not only bad economics; it is also bad politics.

Third, the question today is the direction in which the Administration, through OMB, intends to resolve this controversy and to end its debilitating effects on small businesses and effective pollution control. It has been suggested that the $40 million allowed by OMB for the F82 First Quarter may be a signal of a willingness to compromise, that is, an annualization at that quarterly level would mean an F82 authorization of $160 million. This would be substantially greater than previous fiscal years and the prior announcements of the Administration. While it would be less than the $250 million intended by Congress, it would be proximate to the $175 million once sought by Congress.

I think the willingness of small business to accept this $160 million level, or at least of the Coalition and the small businesses it represents to accept it, would depend on the credibility of simultaneous assurances of OMB. Those would have to be no less than the following:

1. Assurance that the Administration's request for F83 will be no less than $250 million, because the need is growing, not declining.

2. Assurance that SBA will not be otherwise restricted by OMB from closing on guarantees in this fiscal year necessary to attain that $160 million level.

3. Assurance that Administration policy will be to support the continued tax-exemption of IRBs specifically intended for pollution control facilities.

The second assurance brings me to the second major point within this issue; the third assurance to the third major point.

Personnel Ceiling: SBA Pollution Control Financing Section

The Office of Management and Budget, as we know, controls not only dollars but also the level of personnel by which those dollars are transacted. In short as to the latter, it sets the ceiling for agencies, like SBA, and for various offices, branchs and sections therein.

It goes without saying also that OMB knows all the tricks. This is not said in any way to cast aspersions or to question motives; it is simply the reality that OMB has been at this far longer than anyone else and has learned much in the process.

One of the things it has learned is that it can finally yield to a Congressional and public pressure on an annual authorization, agree on the level demanded by Congress or the public or agree on a compromised level, and still frustrate the program. It does that by giving the agency less of a personnel level than is required to undertake fully the annual program. For example, if it takes three program officers to review and close on $250 million, two officers, working tirelessly, would be able to review and close on only about $160-$175 million. That is a hypothetical not intended to be identified with this specific SBA program, but we do know that SBA's Pollution Control Financing Section has less personnel today than it did last fiscal year when it could only close on approximately $100 million in guarantees.

I think this makes the case for why the second assurance I set forth is crucial.

The Future of Tax-Exempted Industrial Revenue Bonds for Pollution Control Financing

The third assurance sought by us is as important, many think even more so over the longer run. It is the position of the Administration on the future of tax-exempted industrial revenue bonds the proceeds of which are intended to finance pollution control facilities. It is a matter not only before the Administration but also before the Congress and its tax-writing House Committee on Ways and Means and Senate Committee on Finance.

This issue is whether, in the Administration's broad attack against tax-exempted IRBs, it will attack those intended for pollution control facilities financing but not within the specific Code exemption for pollution control-directed IRBs. This latter, specific exemption is seldom used because of severe regulatory limitations associated with it.

On August 24, 1981, the Internal Revenue Service announced Revenue Ruling 81-216 through the issuance of IR-81-98, such ruling holding that multiple lots of bonds of up to $1 million each will be treated as a single large issue not qualifying under IRC §103(b)(6)(A) for tax-exempted treatment if (1) sold at substantially the same time, (2) sold under a common plan of marketing, (3) sold at substantially the same rate of interest, and (4) common or pooled security will be either used or available to pay debt service on the obligation. The ruling was published in IR Bulletin 1981-36 of September 8, 1981. On September 3, 1981, IRS announced through IR-81-102 that there would be limited but expedited relief to persons adversely affected by Rev. Rul. 81-216, if it could be demonstrated that there was a significant financial commitment made toward the issuance of the obligations and there was reliance on the revenue rulings revoked by Rev. Rul. 81-216. Then, on October 1, 1981, IRS published at

46 FR 50014-5 a Notice of Proposed Rulemaking to supercede Rev. Ruling 81-216 with a public hearing thereon to be held on November 12, 1981 in Washington and formal comments thereon to be made by December 7, 1981. To further complicate an already complicated situation, Congress began moving on the issue through proposed amendments to the F82 appropriations for Treasury and continuing resolutions dealing with appropriations.

When one understands the way in which IRBs are packaged and offered when the intention is to use the proceeds to finance pollution control facilities, one understands why any final rule similar to Rev. Rul. 81-216 could be a disaster.

Pollution control revenue bonds guaranteed through SBA provide attractive rates and terms, usually 20 years, because of the high investment-grade quality which the SBA guarantee provides. But tax-exemption is as crucial.

Here, briefly, is how we understand the bond procedure typically works. A qualified financial institution, e.g., a bank, solicits potentially eligible companies, companies truly in need, through one or more of several sources, for example, regulatory authorities, trade associations, and requests or inquiries from State issuing authorities. The institution then financially qualifies the business through standard questions. With assistance from the institution, the small business submits an application to the State pollution control financing agency. That agency then issues an initial or "inducement" resolution giving tentative approval, pending the recommendation of bond counsel and the appropriate pollution control agency. This establishes formal eligibility for tax-exempt financing.

Following this action, the small business is advised and assisted by

the institution in preparing a separate application to SBA. This application confirms the small business's creditworthiness and ability to repay the debt, as well as that the project is for pollution control, as defined by SBA regulations. In addition, the small business's bank provides SBA a detailed and favorable credit analysis as to that creditworthiness, an analysis provided without fee. SBA then approves the company's application and provides the issuer a written commitment to guarantee the repayment of the bonds if the company were to default. The SBA approval process is thorough; applicants are rejected, as well as approved; additional information is sometimes sought. It is arm's length.

When the number of companies in the pool of approved applications is about $5 million, a bond sale is negotiated with the financial institution as Underwriter. There are usually two to four other members of the underwriting syndicate. Funds from the bond proceeds are disbursed to the small businesses upon receipt by the State as Trustee. Repayment of bond proceeds are made to the State by the small businesses in equal monthly payments which start one month after the sale of the bonds. Reserve funds are held by the State in case of default. SBA payments start after the 3 month reserve is exhausted.

There are variations on theme, but what I have just described is usually the case.

But, there is something much more here. It is how the bond market responds to these bonds. A bond must be attractive. A tax-exemption makes it attractive; the buyer is willing to take a lower rate of interest because that income is tax-exempt. When someone is considering new bonds, he

or she will go through the stack of what is available, and tax-exemption is crucial to assuring further consideration.

The issuance of small issue IRBs during F81 for all purposes has been estimated at $8 billion. This SBA program's contribution to that is slightly more than 1%, hardly a danger to the tax revenues of the Treasury. In addition, the public benefits derived from the program are disproportionately high.

We understand Treasury's concerns with respect to tax revenue losses, but we also understand what Treasury and the Administration must come to know: tax revenue losses from these small businesses closing their doors, if inability to comply with abatement policies results in that, will have far greater tax revenue loss consequences. Far greater.

Congress and the Administration must preserve the tax-exempt status of pollution control directed IRBs.

Summary

The Coalition fully supports this Committee and this Congress in seeking an F82 annual authorization of $250 million. We believe OMB should allow SBA to proceed at that level. The case is clear; the merits are with it:

- The program actually makes money for the U.S. Government.
- The program has a pristine actuarial integrity.
- The program does not interfere with capital markets.
- The program does allow equal access by small business to those capital markets.
- The program constituted less than 1% of the small IRB issues in F81.

- The program has public benefits, particularly pollution abatement which are disproportionately high, compared to other IRB-financed projects.
- The program has one of the smallest administrative staffs on record.
- The program is funded with private sector funds, only guaranteed by the Federal Government.
- The program has benefitted small businesses in more than thirty States, representing over 20,000 jobs.

The Coalition has articulated a "compromise" in this Statement, not because we believe in a compromise, for the Administration should obey the law and the law is $250 million in F82, but rather because we believe strongly in the three assurances which must be a part of any compromise which should emerge.

The plea of this Coalition is more directed at the Administration than it is at this Committee or this Congress, for the latter two know the merits. We hope the Administration comes to know them in the coming days and weeks.

○